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BEFORE THE ARIZONA CORPORATI

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COMMISSIONERS

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

IN THE MATTER OF THE APPLICATION OF
ARIZONA-AMERICAN WATER COMPANY,
INC., AN ARIZONA CORPORATION, TO
EXAMINE POSSIBLE FORMS OF
MITIGATION OF THE ACRM FOR HAVASU
WATER DISTRICT.

DOCKET NO. W-01303A-05-0890

**STAFF'S NOTICE OF FILING
OF REBUTTAL DIRECT TESTIMONY**

The Utilities Division ("Staff") hereby provides notice of filing of the Rebuttal Testimony of
Staff Witness Crystal W. Brown.

RESPECTFULLY SUBMITTED this 28th day of April 2006.

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Copy of the foregoing mailed this
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AZ CORP COMMISSION
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**REBUTTAL
TESTIMONY
OF
CRYSTAL S. BROWN**

DOCKET NO. W-01303A-05-0890

**IN THE MATTER OF THE APPLICATION OF
ARIZONA-AMERICAN WATER COMPANY,
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DISTRICT.**

APRIL 28, 2006

BEFORE THE ARIZONA CORPORATION COMMISSION

JEFF HATCH-MILLER
Chairman
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Commissioner
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DISTRICT.)
_____)

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REBUTTAL
TESTIMONY
OF
CRYSTAL S. BROWN
PUBLIC UTILITIES ANALYST V
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION

APRIL 28, 2006

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EXECUTIVE SUMMARY
ARIZONA-AMERICAN WATER COMPANY
DOCKET NO. W-01303A-05-0890

Arizona-American Water Company, Inc. (“Arizona-American” or “Company”) provides potable water, irrigation water, and wastewater services to approximately 115,000 customers in Arizona.

On April 15, 2005, Arizona-American filed an application for authority to implement Arsenic Cost Recovery Mechanisms (“ACRM”) for its Agua Fria, Sun City West, Havasu, and Tubac Water Districts. On May 4, 2005, Arizona-American filed a motion to delete Tubac Water District from its application.

On May 31, 2005, Arizona-American filed its request for an Arsenic Impact Fee Tariff for the Havasu Water District.

On November 14, 2005, the Arizona Corporation Commission (“Commission”), in Decision No. 68310, along with other items, authorized an ACRM for customers in the Havasu Water District and directed Utilities Division (“Staff”) and the Company to “examine other forms of mitigation of the ACRM for the Havasu system, including the use of hook-up fees for adjacent systems.”¹

On December 13, 2005, Arizona-American, filed a new application to examine possible forms of mitigation of the ACRM and present its findings and proposals to the Commission.

On January 23, 2006, Staff filed testimony recommending, subject to three modifications, adoption of the Company’s proposal to mitigate the ACRM impact by capitalizing and deferring recovery of 12 months of recoverable O&M expense.

By Procedural Order, dated March 23, 2006, the Company was directed to file Direct Testimony and associated exhibits on or before April 21, 2006. On April 21, 2006, the Company filed testimony that is in agreement with Staff’s modified recommendations with the exception that the Company does not agree to recognize Accumulated Deferred Income Taxes (“ADIT”) in the arsenic rate base calculation.

Staff reviewed the Company’s direct testimony and continues to recommend ADIT in the arsenic rate base calculation as a tool to mitigate the impact of the ACRM.

¹ Decision No. 68310, dated November 14, 2005, page 17, beginning at line 1.

1 **INTRODUCTION**

2 **Q. Please state your name, occupation, and business address.**

3 A. My name is Crystal S. Brown. I am a Public Utilities Analyst V employed by the Arizona
4 Corporation Commission (“ACC” or “Commission”) in the Utilities Division (“Staff”).
5 My business address is 1200 West Washington Street, Phoenix, Arizona 85007.

6
7 **Q. Are you the same Crystal S. Brown who filed direct testimony in this case?**

8 A. Yes.

9
10 **PURPOSE OF REBUTTAL TESTIMONY**

11 **Q. What is the purpose of your rebuttal testimony in this proceeding?**

12 A. The purpose of my rebuttal testimony in this proceeding is to respond, on behalf of the
13 Staff, to the direct testimony of Mr. Thomas M. Broderick, who represents Arizona-
14 American Water Company, Inc. (“Arizona-American” or “Company”).

15
16 **BACKGROUND**

17 **Q. Please review the background of this application.**

18 A. Arizona-American Water Company, Inc. provides potable water, irrigation water, and
19 wastewater services to approximately 115,000 customers in Arizona.

20
21 On November 22 and December 13, 2002, Arizona-American filed applications for fair
22 value determinations of its utility plant and for permanent rate increases for five of its
23 districts. On June 30, 2005, the Commission issued Decision No. 67093 that established
24 fair values and authorized permanent rate increases for the five districts.

25 On December 17, 2004, Arizona-American filed a motion to request that the Commission
26 re-open the record in Decision No. 67093. The purpose of the motion was to provide an

1 evidentiary basis that would allow the Commission to consider modifying the order so that
2 an Arsenic Cost Recovery Mechanism (“ACRM”) could be added. Decision No. 67593,
3 dated February 15, 2005, authorized the re-opening of the rate case order “solely for
4 adding an Arsenic Recovery Mechanism.”

5
6 On March 29, 2005, Arizona-American was directed by procedural order to file a new
7 application requesting an ACRM. The new application was to include all dockets from
8 Decision No. 67093 that would be affected by the ACRM request. On April 15, 2005,
9 Arizona-American filed an application for authority to implement ACRMs for its Agua
10 Fria, Sun City West, Havasu Water, and Tubac Water Districts. Additionally, the
11 Company requested a hook-up fee for its Havasu and Tubac Water Districts. On May 4,
12 2005, Arizona-American filed a motion to delete Tubac Water District from its
13 application.

14
15 On May 31, 2005, Arizona-American filed its request for an Arsenic Impact Fee Tariff for
16 the Havasu water district. On June 8, 2005, Arizona-American filed revised direct
17 testimony for Company witness, Thomas M. Broderick.

18
19 On November 14, 2005, the Commission, in Decision No. 68310, along with other items,
20 authorized an ACRM for customers in the Havasu Water District and directed Staff and
21 the Company to “examine other forms of mitigation of the ACRM for the Havasu system,
22 including the use of hook-up fees for adjacent systems.”

1 On December 13, 2005, Arizona-American, filed a new application that proposed the
2 following forms of ACRM mitigation:

- 3 1. To capitalize 12 months of recoverable operations and maintenance (“O&M”)
4 deferred in Step One² and amortize the capitalized amount over the remaining life
5 of the arsenic treatment plant instead of recovering them in one year through the
6 ACRM surcharge or
- 7 2. Implement a temporary hook-up fee paid by customers of the Company’s Mohave
8 district.

9
10 The Company indicated its preference for the first proposal.

11
12 On January 23, 2006, Staff filed testimony recommending the Company’s first proposal to
13 capitalize and defer recovery of 12 months of recoverable O&M expense subject to three
14 modifications:

- 15 1. The start date of the AFUDC accrual should begin at the effective date of the Step
16 Two filing
 - 17 2. Accumulated amortization of CIAC related to arsenic treatment plant is recognized
18 in the arsenic rate base calculation³ and
 - 19 3. Recognition of accumulated deferred income taxes related to arsenic treatment
20 plant in the arsenic rate base calculation
- 21

² The costs authorized for recovery through a surcharge under the Step One ACRM filing are depreciation expense and return on arsenic treatment plant (i.e., capital costs). The plant must be in service and providing water that meets EPA drinking water standards. In addition, media replacement or regeneration, media replacement or regeneration service, and waste disposal O&M expenses incurred during the first year of operation² are authorized for deferral and recovery at a later date (i.e., during the Step Two filing). The Step One filing would be filed no earlier than January 24, 2006.

³ More correctly, this is the correction of an omission instead of a modification to the Company’s recommendation.

1 By Procedural Order, dated March 23, 2006, the Company was directed to file Direct
2 Testimony and associated exhibits on or before April 21, 2006.

3
4 **Recognition of accumulated deferred income taxes ("ADIT") related to arsenic treatment**
5 **plant in the arsenic rate base calculation**

6 **Q. Has Staff reviewed the Company's testimony concerning recognition of ADIT?**

7 A. Yes.

8
9 **Q. What arguments did the Company present to oppose Staff's recommendation to**
10 **recognize ADIT in the arsenic rate base calculation?**

11 A. The Company's arguments are as follows:

- 12 1. Settlement of the ACRM formula – The Company states that the ACRM formula
13 has been settled, therefore, the mitigation proceeding should not alter the basic
14 design of the ACRM.
- 15 2. Company's financial status – The Company states that it is unprofitable, pays no
16 dividends, has negative retained earnings and forecasts an actual loss of income in
17 2006.

18
19 **Settlement of the ACRM Mechanism**

20 **Q. What does Commission Decision No. 68310 say regarding mitigation of the Havasu**
21 **ACRM?**

22 A. Findings of Fact No. 29 states:

23 The Commission is concerned about the impact on the bills of customers
24 served by the Havasu system from the implementation of the ACRM.
25 Consequently, we direct Staff and the Company to open a new proceeding

1 to examine other forms of mitigation of the ACRM for the Havasu system,
2 including the use of hook-up fees for the adjacent systems.

3
4 The Commission did not place a limitation on the forms of mitigation to be considered.
5 Therefore, Staff presumes that modification of the ACRM along with the corresponding
6 revenue implications were to be considered.

7
8 **Q. Would recognition of ADIT in the arsenic rate base calculation have the potential to**
9 **mitigate the impact of the ACRM?**

10 A. Yes. Generally, new plant initially results in an ADIT credit balance. An ADIT credit is a
11 subtraction from rate base because it reflects that customers are paying for taxes through
12 rates in advance of the Company's cash payment to the federal and state governments for
13 its income taxes. Due to the relatively short time the arsenic plant is anticipated to be in
14 service prior to the Company's ACRM filings, the impact of ADIT on the resulting
15 surcharge is likely to be minimal. Nevertheless, ADIT is normally a component of rate
16 base and in an effort to service the Commission's directive to mitigate the impact of the
17 ACRM, Staff recommends including ADIT in the Havasu ADIT.

18

19 **Financial Status of Company**

20 **Q. What is Staff's response to the Company's implication that ADIT should not be**
21 **included in the Havasu ACRM rate base because of its financial status?**

22 A. These are new financial issues not subject to litigation in the rate portion of this docket
23 and are more appropriately addressed in a future permanent rate case proceeding.

1 **Q. Does Staff continue to recommend recognition of ADIT in the Havasu ACRM rate**
2 **base calculation?**

3 A. Yes.

4

5 **Q. Please summarize Staff's recommendations.**

6 A. Accumulated deferred income taxes are a normal component of rate base. ADIT has the
7 potential to mitigate the impact of the ACRM. Therefore, Staff continues to recommend
8 recognition of ADIT in the arsenic rate base.

9

10 **Q. Does this conclude your rebuttal testimony?**

11 A. Yes, it does.