

# ORIGINAL EXCEPTION



0000056956

OPEN MEETING AGENDA ITEM

BEFORE THE ARIZONA CORPORATION CO.

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Arizona Corporation Commission

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8 IN THE MATTER OF THE APPLICATION OF  
9 ARIZONA-AMERICAN WATER COMPANY,  
10 INC., AN ARIZONA CORPORATION, FOR A  
11 DETERMINATION OF THE CURRENT FAIR  
12 VALUE OF ITS UTILITY PLANT AND  
13 PROPERTY AND FOR INCREASES IN ITS  
14 RATES AND CHARGES BASED THEREON  
15 FOR UTILITY SERVICE BY ITS PARADISE  
16 VALLEY WATER DISTRICT.

Docket No. W-01303A-05-0405

13 IN THE MATTER OF THE APPLICATION OF  
14 ARIZONA-AMERICAN WATER COMPANY  
15 FOR APPROVAL OF AN AGREEMENT  
16 WITH THE PARADISE VALLEY COUNTRY  
17 CLUB.

Docket No. W-01303A-05-0910

## EXCEPTIONS OF THE RESIDENTIAL UTILITY CONSUMER OFFICE

17 The Residential Utility Consumer Office ("RUCO") makes the following Exceptions to  
18 the Recommended Opinion and Order ("ROO") on Arizona American Water Company's  
19 ("Arizona American" or "Company") application for a rate increase.

### 21 FIRE FLOW IMPROVEMENTS

22 The ROO recommends the inclusion of \$3,018,867 of post-test year plant consisting of  
23 discretionary fire flow improvement projects. The issue, which RUCO points out, and the ROO  
24 agrees, is whether deferred expenses incurred by the Company for fire flow improvements

1 should be allowed in ratebase. ROO at 11. The issue is not whether the improvements are  
2 necessary to ensure the public safety, are used and useful or whether the ratepayers support  
3 the improvements. The ROO answers these questions in the affirmative and cites them as the  
4 reason why the Commission should include over \$3,000,000 in discretionary expenditures.

5 RUCO does not take issue with the contention that the discretionary improvements  
6 ensure public safety, are used and useful, or that some ratepayers support the improvements<sup>1</sup>.  
7 However, the ROO misses the point. The fact that the improvements ensure public safety, are  
8 used and useful and are supported by ratepayers does not answer the question of who should  
9 pay for them. These points, at best, provide a reason why the Town of Paradise Valley needs  
10 to improve its fire flow system, and not the reason why ratepayers should be the ones to pay  
11 for discretionary fire flow improvements.

12 Perhaps the reason why the ROO, Staff and the Company have not provided a reason  
13 why ratepayers should pay for improvements that even the Company considers discretionary  
14 is because it comes down to a policy call. In this time of soaring utility rates in every sector the  
15 Commission regulates, it is bad policy to allow utilities to ratebase discretionary expenditures  
16 and supersede the Commission's ability to regulate costs and prices. The Commission, on  
17 numerous occasions, has stated the need for utilities to "cut the fat out" and pass through to  
18 ratepayers expenditures that are only necessary for the provision of service. The Commission  
19 should remain steadfast and consistent and reject the Company's request to include  
20 discretionary expenditures.

21 The Commission is not in the business of setting fire flow standards any more than it is  
22 in the business of marketing a utility to the public. Is the Commission now going to start  
23

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24 <sup>1</sup> Interestingly, while the Company has made that contention, no public member who appeared at the  
Commission's public comment supported the improvements.

1 distinguishing between what types of "fat" it will include in rate base and what it will not  
2 include? Allowing discretionary expenditures, of any type, into a utility's rate base is unfair to  
3 customers. The Commission should not jeopardize the affordability of water in Arizona by  
4 including discretionary and costly fire flow improvements in customers' rates<sup>2</sup>. (See Exhibit A,  
5 RUCO's Amendment No. 1)

## 7 **PROPERTY TAX EXPENSE**

8 The ROO rejects RUCO's property tax recommendation. RUCO has unsuccessfully  
9 argued its position before this Commission on numerous occasions and RUCO still maintains  
10 that its methodology results in the most accurate estimate of property tax. Stated simply  
11 RUCO's methodology is the same methodology using the same inputs that the Arizona  
12 Department of Revenue ("ADOR") developed at the request of the association of Arizona's  
13 water utilities back in 2001. The ROO discredits RUCO's recommendation by citing several  
14 Decisions where the Commission has rejected RUCO's proposed methodology. The ROO,  
15 apparently in support of its recommendation notes that RUCO has not appealed any of the  
16 Commission's Decisions. See ROO, Footnote 15 at page 18.

17 The fact that RUCO has not appealed the Commission's prior Decisions on this issue is  
18 irrelevant. The ROO's notation of RUCO's decision not to appeal in the past is prejudicial to  
19 RUCO and should be stricken. There are many factors that go into a decision to appeal

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21 <sup>2</sup> To a lesser degree, Footnote 6 of the ROO needs to be addressed. The ROO is critical of RUCO's argument  
22 that interpreting the Town's Code to require a utility to fund increased fire flow improvements impinges on the  
23 Commission's exclusive ratemaking authority. The ROO notes that RUCO makes no similar argument against  
24 approval of the ACRM in this proceeding. ROO at 9. Unlike the situation with the Town code, federal law is  
superior to the Commission's regulatory authority under the Supremacy Clause of the United States Constitution.  
Article VI, Paragraph 2 of the United States Constitution. The Commission's regulatory authority is superior to the  
Town's code in cases where there is a conflict and the matter is of both local and statewide concern. Ariz.  
Const. art. IV, pt. 1, § 1(8); Strode v. Sullivan, 72 Ariz. 360, 363, 236 P.2d 48, 50 (1951). Mayor and  
Common Council of City of Prescott v. Randall, 67 Ariz. 369, 372, 196 P.2d 477, 479 (1948); City of  
Tucson v. State, 191 Ariz. 436, 438, 957 P.2d 341, 343 (1997).

1 beyond the merits of the property tax question in this case. RUCO's decision to not appeal  
2 previous decisions does not have any bearing one way or the other on the merits of RUCO's  
3 arguments. The property tax question is not a legal question, it is a policy question. RUCO's  
4 decision to not appeal does not mean that RUCO has not reached the right policy position on  
5 this issue<sup>3</sup>. The Commission should strike the ROO's reference to the appeal history on this  
6 issue. (See Exhibit B, RUCO's Amendment No. 2)

7         The ROO's reference to RUCO's failure to address the level of property tax expense for  
8 the period in which new rates will be in effect (and not for 2005) is also misplaced and should  
9 be stricken. See ROO, Footnote 16 at 19. This gets to the heart of the issue and is why  
10 RUCO maintains the ROO's recommended methodology is wrong. The impact of additional  
11 revenues on property tax is not the same as the impact of additional revenues on income  
12 taxes. Whereas the effect of additional revenues on income tax is immediate, the effect of  
13 additional revenues on property taxes is not immediate because property taxes based on the  
14 increased revenues are not paid until more than a year after new rates go into effect. Even  
15 then the increased revenues' impact on property taxes is tempered by the use of two earlier  
16 years' revenues. The full impact of increased revenues on property taxes will not be felt until  
17 four years after new rates go into effect. An understanding of this timing difference is critical  
18 to understand why the ADOR formula using historical inputs is a more accurate method to  
19 estimate property taxes than what the ROO recommends. This also explains why the new  
20 rates that will go into effect will not affect property taxes immediately. In RUCO's experience,  
21 the Commission has not gone more than one year beyond the test year to look at any other  
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23  
24 <sup>3</sup> In general, there does appear to be some frustration with RUCO advocating a position that has been  
unsuccessful before this Commission. Nonetheless, RUCO will not change a position that it not only believes but  
knows is right because parties and/or the Commission does not agree. RUCO makes its argument in good faith,  
RUCO can support it, and hopes that the Commission will come to see that RUCO is right.

1 expense on the income statement. Here, the test year was 2004, and one year beyond that is  
2 2005. RUCO established a level of property tax for 2005.

3 The ROO recommends the Commission look beyond one year from the test year and  
4 consider new rates to estimate property tax expenses more than one year into the future.  
5 Historically, the Commission does not consider a post-test-year expense beyond one year  
6 because, among other things, it violates the matching principle and the used and useful  
7 principle. The ADOR formula using historical inputs, as RUCO has stated many times before,  
8 is forward looking and does consider the fact that new rates will be set. The Commission  
9 should strike the ROO's incorrect statement regarding RUCO's failure to address new rates in  
10 its property tax recommendation (Footnote 16, last sentence) and adopt RUCO's level of  
11 property tax expense. (See Exhibit B, RUCO's Amendment No. 2)

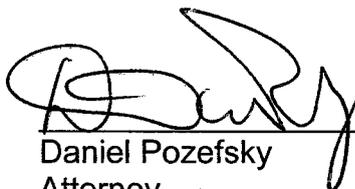
12 Finally, the ROO should exclude the Miller Road property taxes, as they are part of the  
13 Company's property tax expense using RUCO's recommended property tax methodology.  
14 (See Exhibit B, RUCO's Amendment No. 2)

15  
16 **LABOR AND PENSION EXPENSE**

17 The ROO recommends inclusion of the operation and maintenance expenses  
18 associated with the annual labor cost of an arsenic plant operator the Company hired in  
19 October 2004. ROO at 17. The total amount involved, \$48,103, should be omitted from the  
20 rates and considered when the Company files its next rate case. The parties agreed to an  
21 ACRM that by definition was to include only narrowly construed costs associated with the  
22 building of arsenic treatment plants and the operation and maintenance thereof. To date, the  
23 construction of Paradise Valley's treatment plant is not complete, and any costs associated  
24 therewith should not be included in rates.

1 It should go without saying that the costs associated with the operation of arsenic  
2 removal from other arsenic treatment plants in the Company's system should not be included  
3 in rates as the ROO recommends. ROO at 18, lines 5-6. The Company's arsenic plant  
4 operator will also be performing services for two other Arizona-American Divisions that require  
5 arsenic treatment plants. To be fair RUCO believes that should the Commission include the  
6 expense of the operator at this time, it should only include one third of the total, \$16,034, as  
7 attributable to the Paradise Valley plant. The other two-thirds should be attributed to the  
8 Company's other Divisions and should be excluded from rates. The Commission should not  
9 include the arsenic employee expense in rates; but if the Commission does consider it, it  
10 should only include Paradise Valley's share, \$16,034. (See Exhibit C, RUCO's Amendment  
11 No. 3)

12  
13 RESPECTFULLY SUBMITTED this 20th day of July, 2006.

14  
15   
16 Daniel Pozefsky  
17 Attorney

18 AN ORIGINAL AND FIFTEEN COPIES  
19 of the foregoing filed this 20th day  
20 of July, 2006 with:

21 Docket Control  
22 Arizona Corporation Commission  
23 1200 West Washington  
24 Phoenix, Arizona 85007

1 COPIES of the foregoing hand delivered/  
mailed this 20<sup>th</sup> day of July, 2006 to:

2  
3 Lynn Farmer  
4 Chief Administrative Law Judge  
5 Hearing Division  
6 Arizona Corporation Commission  
7 1200 West Washington  
8 Phoenix, Arizona 85007

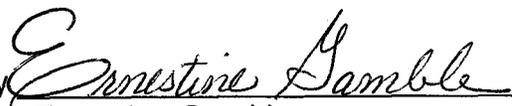
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21  
22 By   
23 Ernestine Gamble

24

**Exhibit A**  
**RUCO's Amendment No. 1**

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Page 9 Footnote 6

DELETE Footnote 6

Page 12 Line 8

DELETE Page 12, line 8 through page 12, line 15.

INSERT While the record indicates that there is a need for fire flow improvements in the Town of Paradise Valley, the issue is who should pay for the improvements. The Commission is not in the business of setting fire flow standards and will not establish a policy of establishing fire flow standards in this case. Fire flow improvements are discretionary expenditures on the part of the utility and should not be allowed in rate base.

It is not reasonable to include \$3,018,867 of post-test year plant consisting of fire flow improvement projects, known as the Jackrabbit/Invergordon project, in test year plant in service.

**Exhibit B**  
**RUCO'S Amendment No. 2**

Page 18 lines 10-13

DELETE Page 18, lines 27 – 28 “RUCO has not appealed any of these Decisions.”

Page 19 lines 3-9

DELETE The paragraph, including footnote 16

INSERT The ADOR formula utilized by RUCO is the best measure of the Company's property taxes. The method proposed by the Company and Staff applies adjusted and proposed revenues to the ADOR formula and is likely to result in the Company over earning. RUCO's calculation of property tax expense yields the best measure of the Company's property tax expense for the period in which new rates will be in effect, and we will use that calculation.

Lines 20 -22

DELETE The sentence.

INSERT We agree with RUCO that its adjustment would be appropriate because property taxes related to the Miller Road Property are included in RUCO's property tax expense.

**Exhibit C**  
**RUCO'S Amendment No. 3**

Page 18 lines 10-13

**DELETE** We wish to encourage water utilities to make the necessary financial commitments to satisfy the federal arsenic mandate, and find that under these specific circumstances, it is equitable to include the costs of this employee in test year expense.

**INSERT** At this time, construction of the arsenic treatment facilities for Paradise Valley has not been completed and under the Arsenic Cost Recovery Mechanism agreed to by the parties, the expenses related to this employee are not subject to inclusion in rates at this point in time. The costs of this employee shall not be included in test year expenses.