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BEFORE THE ARIZONA CORPORATION COMMISSION

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CHAIRMAN

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Arizona Corporation Commission  
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8 IN THE MATTER OF THE APPLICATION OF  
ARIZONA WATER COMPANY, AN ARIZONA  
9 CORPORATION, FOR ADJUSTMENTS TO  
10 ITS RATES AND CHARGES FOR UTILITY  
SERVICE FURNISHED BY ITS NORTHERN  
11 GROUP AND FOR CERTAIN RELATED  
APPROVALS.

Docket No. W-01445A-00-0962

**NOTICE OF FILING**

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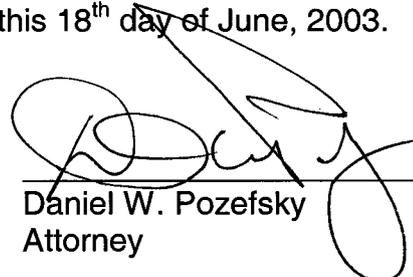
13 The Residential Utility Consumer Office ("RUCO") hereby provides notice of filing the

14 Phase II Supplemental Direct Testimony of Marylee Diaz Cortez, in the above-referenced

15 matter.

16 RESPECTFULLY SUBMITTED this 18<sup>th</sup> day of June, 2003.

17

18 

19 Daniel W. Pozefsky  
Attorney

1 AN ORIGINAL AND THIRTEEN COPIES  
of the foregoing filed this 18<sup>th</sup> day  
2 of June, 2003 with:

3 Docket Control  
Arizona Corporation Commission  
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Phoenix, Arizona 85007

5 COPIES of the foregoing hand delivered/  
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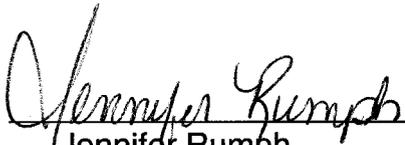
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By   
Jennifer Rumph

ARIZONA WATER COMPANY  
DOCKET NO. W-01445A-00-0962

PHASE II

SUPPLEMENTAL DIRECT TESTIMONY  
OF  
MARYLEE DIAZ CORTEZ

ON BEHALF OF  
THE  
RESIDENTIAL UTILITY CONSUMER OFFICE

JUNE 18, 2003

1	Introduction .....	1
2	The Recommended Opinion and Order .....	3
3	Arsenic Lease Discussions .....	5
4	RUCO's Recommendation .....	6

5

6

1 **Introduction**

2 Q. Please state your name for the record.

3 A. My name is Marylee Diaz Cortez.

4  
5 Q. Have you previously filed testimony in this docket?

6 A. Yes. In Phase I of this docket I filed testimony on June 26, 2001, surrebuttal  
7 testimony on August 21, 2001, provided oral testimony on the Phase I hearing  
8 beginning on September 5, 2001. In the Phase II portion of this docket I filed  
9 direct testimony on September 23, 2002, and provided oral testimony at the  
10 hearing beginning on October 3, 2002.

11  
12 Q. What issues were resolved in the Phase I portion of this docket?

13 A. Rate base, operating income, cost of capital, and the overall revenue  
14 requirement issues were resolved by Decision No. 64282.

15  
16 Q. What was the purpose of the Phase II portion of this docket?

17 A. The purpose of the Phase II portion of this docket was to address the following  
18 two issues:

- 19 1) Formulation of a mechanism for the recovery of arsenic treatment  
20 costs; and  
21 2) Consideration of rate consolidation among certain systems for  
22 purposes of arsenic cost recovery.

1 Q. What position did RUCO take on these issues?

2 A. RUCO's position on these issues was set forth in its direct testimony filed on  
3 September 23, 2002 and at the hearing on October 3, 2002. In summary, RUCO  
4 made the following recommendations:

5 1) Establish an Arsenic Cost Recovery Mechanism (ACRM) that  
6 would allow the Company to file for recovery of its investment in  
7 arsenic treatment plant, without having to file an additional rate  
8 case;

9 2) The ACRM filing would be an abbreviated procedure limited to  
10 recovery of completed, used and useful arsenic plant.

11 3) The ability to confine the filing to an abbreviated procedure would  
12 only be possible by limiting the scope of the filing to arsenic plant  
13 investment. Additional issues such as consideration of operating  
14 and maintenance (O&M) costs would create the need for full rate  
15 review in order to avoid piecemeal ratemaking.

16 4) The ACRM should be set for each water system on a stand-alone  
17 cost of service basis. This will prevent the cross-subsidization  
18 among systems that is inherent in rate consolidation.

19 5) Arizona Water would be limited to two rate filings under the ACRM  
20 procedure and a full rate case filing would be required in 2006.

21

22

1 **The Recommended Opinion and Order**

2 Q. After a full hearing on these issues did the Administrative Law Judge issue a  
3 Recommended Opinion and Order?

4 A. Yes. The Administrative Law Judge issued a twenty page Recommended  
5 Opinion and Order resolving all the issues set forth in the Phase II portion of this  
6 docket.

7  
8 Q. Please summarize the Recommended Opinion and Order's resolution of the  
9 issues?

10 A. The Recommended Opinion and Order found the following:

- 11 1) It is appropriate for Arizona Water to recover through the ACRM capital  
12 costs associated with arsenic treatment compliance. However, O&M  
13 costs may not properly be recovered through the ACRM.
- 14 2) Arizona Water may seek two-step increases through the ACRM process  
15 during the interim period prior to its general rate application in 2007.
- 16 3) Arizona Water shall file a full rate application by no later than September  
17 30, 2007, based on a 2006 test year.
- 18 4) Arizona Water's proposal to consolidate the Sedona and Rimrock systems  
19 for ratemaking purposes is a reasonable approach to mitigate the  
20 significant rate impact that is expected to be experienced by customers in  
21 those systems.
- 22 5) The "earnings test" that is to be employed during Staff's audit of the  
23 ACRM step increases is properly based on a system basis, rather than a

1           group basis, consistent with the establishment of general rates on a  
2           system by system basis.

3  
4   Q.    Did the Phase II Recommended Opinion and Order go to Open Meeting for  
5           Commission consideration?

6   A.    Yes. This matter underwent Commission consideration at the April 22, 2003  
7           Open Meeting. Arizona Water filed exceptions to the provision of the  
8           Recommended Opinion and Order that excluded O&M costs from the ACRM.  
9           The Company further argued that the Recommended Opinion and Order made  
10          no provision for how leased arsenic plant would be treated under the ACRM.  
11          Arizona Water argued for the first time that the absence of a leasing provision in  
12          the ACRM would bias the Company's decision toward owning, even if leasing  
13          might be more cost-effective.

14  
15   Q.    In its Phase II application did the Company propose an ACRM methodology for  
16          lease arsenic costs?

17   A.    No. Arizona Water did not mention the issue of arsenic treatment lease costs  
18          prior to filing its exceptions to the Recommended Opinion and Order.  
19          Consequently, there is nothing in the record in this docket to support a ruling on  
20          arsenic lease costs.

1 Q. At April 22, 2003 Open Meeting did the Commissioners' on vote the Phase II  
2 Recommended Opinion and Order?

3 A. No. The Commissioners discussed the Recommended Opinion and Order at  
4 length and ultimately decided that the parties should supplement the evidence in  
5 the record to include the issue of lease costs. A procedural order was issued  
6 that called for discussions among the parties regarding a mutually acceptable  
7 way of handling the lease costs in the ACRM and called for the parties to file  
8 testimony on their individual positions, if an agreement was not reached.

9  
10 **Arsenic Lease Discussions**

11 Q. Pursuant to the Commissioners' request did the parties meet to discuss the  
12 arsenic lease costs?

13 A. Yes. Several meetings took place. As instructed by the Commission, the issue  
14 of lease costs in the ACRM was discussed.

15  
16 Q. Were other aspects of the ACRM beyond the lease issue discussed?

17 A. Yes. Arizona Water and the Staff revisited many of the issues that were already  
18 addressed at the Phase II hearing and ruled upon in the Recommended Opinion  
19 and Order. Specifically, there was much discussion of O&M costs, and property  
20 taxes and how they should be treated in the ACRM. Both the Staff and the  
21 Company set forth various proposals on how they felt the Recommended Order  
22 should have resolved these other issues.

23

1 Q. Did RUCO take a position on these other issues?

2 A. Yes. During discussions RUCO took the position that the Recommended  
3 Opinion and Order had already resolved all the litigated issues and the only  
4 remaining task was to resolve the arsenic lease cost issue, pursuant to the  
5 Commission's request. RUCO indicated that nothing had changed since the  
6 issuance of the Recommended Opinion and Order and that it would not support a  
7 revisit to O&M costs and other already-litigated and resolved issues.

8  
9 **RUCO's Recommendation**

10 Q. What is your recommendation to the Commission on how arsenic lease costs  
11 should be incorporated in the ACRM?

12 A. RUCO believes that the ACRM should be broadened to consider ratemaking  
13 treatment of decisions either to build or lease arsenic plant. The treatment of  
14 lease costs should parallel the ACRM treatment set forth in the Recommended  
15 Opinion and Order for arsenic plant investment. In other words, the manner in  
16 which the ACRM is designed should not in and of itself influence a decision to  
17 lease vs. own.

18  
19 Q. How would this be accomplished?

20 A. The ACRM would allow the portion of the lease payment associated with the  
21 capital cost<sup>1</sup> of the leased arsenic plant to be afforded ratemaking treatment in  
22 the same manner that the capital cost of owned arsenic plant is treated under the

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<sup>1</sup> The lessor would be required to provide a detailed break down of the capital & O&M costs associated with the monthly lease payment.

1 Recommended Opinion and Order. Specifically, the ACRM would afford  
2 recovery of the return on, and depreciation of, the incremental arsenic plant.  
3 O&M costs would not be recovered via the ACRM and would require examination  
4 in a full rate case. This would require an amendment to the Recommended  
5 Opinion and Order to include ACRM recovery of the capital portion of any arsenic  
6 operating leases entered into.

7  
8 Q. Is any other amendment necessary?

9 A. No. The only issue that is not currently resolved by the Recommended Opinion  
10 and Order is the lease issue. Thus, the only amendment required is the lease  
11 amendment.

12  
13 Q. Do you have reason to believe that other parties to this docket may intend to  
14 propose additional amendments, beyond the lease issue?

15 A. Yes. The Staff and Arizona Water have discussed various additional  
16 amendments to the Recommended Opinion and Order, most notably,  
17 amendment to the ACRM's treatment of operating and maintenance expenses.  
18 RUCO, the Staff, and the Company have already prefiled testimony on these  
19 issues and underwent cross-examination on their positions on these aspects of  
20 the ACRM. Those positions are a matter of record and are incorporated in the  
21 Recommended Opinion and Order. Regardless of whether other parties depart  
22 from their prefiled positions, RUCO's positions as set forth in its Phase II direct  
23 testimony remain unchanged.

1 Q. Does this conclude your direct testimony?

2 A. Yes.

3

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