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BEFORE THE ARIZONA CORPORATION COMMISSION

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2006 NOV 29 P 4: 34

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IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY, INC., AN ARIZONA CORPORATION, FOR APPROVALS ASSOCIATED WITH A PROPOSED TRANSACTION WITH MARICOPA COUNTY MUNICIPAL WATER CONSERVATION DISTRICT NUMBER ONE TO ALLOW THE CONSTRUCTION OF A SURFACE WATER TREATMENT FACILITY KNOWN AS THE WHITE TANKS PROJECT

DOCKET NO. W-01303A-05-0718

ARIZONA-AMERICAN WATER COMPANY

REQUEST FOR EXPEDITED HEARING

1 Arizona-American Water Company ("Arizona-American") hereby withdraws its
2 opposition to the Application for Leave to Intervene by the Maricopa Water District ("MWD").
3 Arizona-American now asks the Administrative Law Judge to set an expedited hearing schedule
4 that will allow the parties to investigate and the Commission to evaluate whether Arizona-
5 American should purchase water-treatment services from MWD instead of constructing and
6 financing the White Tanks Water Treatment Plant.

INTRODUCTION

7
8 Based on various pleadings recently filed by MWD, MWD now represents that it will
9 build its water treatment plant regardless of whether Arizona-American proceeds with the White
10 Tanks Plant. If MWD can indeed timely honor this commitment, provide interim water supplies,
11 and supply less expensive treatment services under reasonable contract terms, then this is a
12 welcome turn of events. To fully evaluate MWD's plans, without jeopardizing Arizona-
13 American's ability to provide potable water to new customers in 2009, MWD needs to
14 immediately commit to provide interim water supplies, quickly file supporting testimony,

1 promptly respond to discovery, and be subject to cross examination in an expedited evidentiary
2 hearing.

3 HEARING ISSUES

4 Arizona-American has already filed an initial application, a supporting report and a
5 revised application in this docket and responded to extensive discovery. Both Staff and RUCO
6 have issued reports supporting Arizona-American. Arizona-American can identify sponsoring
7 witnesses for its revised application and offer them for cross examination. Now it is MWD's
8 turn. What follows are some of the many issues that MWD will need to address in its direct
9 testimony.

10 **1. What Will Be The Total Cost Of MWD's Treatment Facility?** This will need to
11 include all costs that MWD expects to recover from its customers, including design, land
12 acquisition, canal upgrades, new pipeline construction, capitalized interest, construction
13 administration, and other soft costs. These costs will need to be escalated for inflation to the
14 planned in-service date. An example of a detailed cost estimate can be found as Exhibit A to
15 Arizona-American's revised application.

16 MWD misleadingly claims that its plant would cost \$20 million less than Arizona-
17 American's. Actually, the base 2006 estimates for MWD's and Arizona-American's facilities
18 are virtually identical: MWD's preliminary estimate is \$47 million,¹ and Arizona-American's
19 final estimate is \$48 million.² Arizona-American's estimate is based on a completed design, not
20 a concept, and includes \$1.35 million in land costs. MWD claims to own land for various sites,
21 but has not yet identified an actual site or said whether it intends to recover the value of the land
22 as part of the plant's cost.³

¹ MWD Preliminary Engineering Report, p. 4-15. (Attached to MWD's Comments).

² Exhibit A to Revised Application.

³ In fairness, MWD claims that its estimate includes one more treatment train, which would bring the plant capacity to 20 MGD, instead of Arizona-American's planned 13.5 MGD. However, as shown on Exhibit A, adding one more 6.5 MGD treatment train to Arizona-American's design would add only another \$2 million or so to the total plant cost. So, even accepting MWD's conceptual estimate at face value, base plant costs would differ by no more than \$2 million.

1 MWD has actually provided a very useful check for Arizona-American's completed
2 design. MWD's own expert, Malcolm Pirnie, has verified that Arizona-American's design is a
3 low-cost option. Of course, an estimate is only that. On November 22, 2006, Arizona-American
4 actually released its completed design for competitive bidding. This will result in an actual,
5 guaranteed plant cost, which can be awarded as soon as this case is concluded.

6 Of course, the cost of a base plant is only a start. MWD will need to determine a plant
7 site. MWD will have to permit and construct canal improvements. MWD will need to construct
8 a large-diameter transmission main to deliver treated water to its customers, or require them to
9 construct such facilities.⁴ MWD will need to hire a firm to design a plant and to supervise
10 construction. MWD will need to borrow the funds needed to build the plant and include all
11 borrowing costs in the completed plant costs. Ultimately, the best case would be that the
12 completed cost of the MWD plant will not be materially different than what Arizona-American
13 estimates and the delay would not be more than a year. The worst case would be that, once
14 MWD completes all these tasks, the completed cost of the plant would be much more than
15 Arizona-American's, and would come on line years later than Arizona-American plans for its
16 White Tanks Plant.

17 Despite what MWD now represents, its borrowing costs should not materially differ from
18 Arizona-American's. In the capital lease presented to the Commission in Arizona-American's
19 original application, MWD's assumed borrowing cost was pegged at the 30-year Treasury bond
20 rate, plus 275 basis points. The basis-point spread was intended to cover MWD's actual
21 borrowing costs, plus required lender reserves and other financing costs. Bloomberg.com lists
22 the 30-year T-bond rate at 4.60%. Based on this, the Commission could reasonably expect
23 MWD to charge its customers approximately 7.35% to finance its project. By contrast, Arizona-
24 American projects an AFUDC rate of less than 7%. At a hearing, MWD can present detailed

⁴ As part of other system upgrades, Arizona-American has already completed a \$10 million transmission main upgrade, which will allow potable water to be delivered all the way from the White Tanks Plant to customers in Verrado. This main is being funded through existing hook-up fees.

1 evidence on how it intends to finance the plant and the total financing costs that its customers
2 will have to cover through treatment payments.

3 **2. When Could MWD Actually Bring Its Plant On Line?** As discussed in various
4 pleadings, Arizona-American requires surface-water treatment capacity by May 2009. This
5 deadline will be difficult to meet—and Arizona-American already owns a completed design, has
6 acquired a site, obtained all permits, and solicited competitive bids.

7 MWD claims that it could complete its plant by mid 2010, but this seems very unlikely.
8 To be able to award a bid in time to meet that deadline, MWD would have to select its
9 technology, decide on a plant site, design a plant, obtain all necessary permits, and award a
10 construction contract by the end of the first quarter of 2008, which is just 16 months away.
11 Although not impossible, meeting this deadline would require that everything go right, but this is
12 unlikely. Further complications could be associated with getting the permits needed to enlarge
13 MWD's Beardsley canal or to construct other ancillary facilities such as new pipelines. What all
14 this means is that Arizona-American and other possible MWD customers would more likely not
15 be served by an MWD plant until 2011 or later.

16 **3. How Can Arizona- American Supply Its Customers' Water Needs Until The**
17 **MWD Plant Comes On Line And At What Cost?** Assuming that the MWD plant does come
18 on line in time to treat water for Arizona-American's customers by mid 2011, what is Arizona-
19 American to do until that time? Arizona-American is adding approximately 3000 customers a
20 year in its Agua Fria Water District. To supply the potable water demands of those customers
21 would require drilling even more wells and building associated infrastructure. There would
22 certainly be a significant cost associated with this construction, some of which could be borne by
23 developers, but some of which will have to be funded through customer rates. Alternatively, if
24 costs are prohibitive or enough water cannot be obtained, a development moratorium could be
25 necessary.

26 MWD has stated that it could supply water to developers. This could help, but MWD has
27 so far required a developer intermediary, before it would make any of its water available to

1 Arizona-American. MWD should commit to make up all shortfalls, with no mark-up, from 2009
2 until its plant actually goes on line.

3 **4. Does MWD Still Want To Put All Plant Risks On Purchasers?** Unless MWD has
4 changed its position, it is unlikely that Arizona-American, or any other entity, would ever
5 contract with MWD. MWD has been unwilling to assume the risks needed to design, build, and
6 operate a large commercial facility. Previous negotiations broke off when MWD insisted upon
7 Arizona-American committing to make capital payments for MWD's treatment plant, even if the
8 plant never entered service, went offline for a year or more, or went permanently out of service.
9 MWD has not yet indicated any willingness to change this position and assume any of these
10 risks, even though they clearly should be borne by the owner of a treatment plant.

11 It would be imprudent for any customer to assume the risk of a prolonged or indefinite
12 plant outage, particularly Arizona-American. If it had contracted with MWD, Arizona-American
13 could have been in the difficult position of having to still pay for its share of the MWD plant,
14 while at the same time paying for alternative water sources.

15 **5. How Much Does MWD Intend To Charge Its Customers?** Presently, all anyone
16 knows is the estimated cost of MWD's conceptual design. As discussed above, MWD has
17 provided no information concerning its ancillary (canal and pipeline) costs, soft costs, financing
18 costs or inflation assumptions. It has not so far backed away from its position that customers
19 should pay for treatment services, even if the plant never enters service or is off-line indefinitely.
20 MWD needs to provide and support reasonably firm dollar/MGD treatment costs, so that the
21 Commission can evaluate its proposal.

22 **6. Is MWD The Best Entity To Provide Potable Water Treatment Service?** MWD
23 does not sell potable water, and has not for 30 years, and has never built or operated a significant
24 water-treatment plant. In the initial transaction contemplated between MWD and Arizona-
25 American, the plant would have been built in accordance with our utility standards, as specified
26 in our design, and under our supervision. Further, the plant would have been operated by an
27 Arizona-American affiliate. It was only under these circumstances that we considered partnering

1 with an entity that has not served a potable water customer in thirty years, let alone designed,
2 built, and operated a major surface water treatment plant.

3 MWD's unwillingness to shoulder normal ownership risks further demonstrated its
4 inexperience in the commercial world. For years, MWD has operated its irrigation business, free
5 from oversight and the need to deal with anyone but its captive landowner/customers, many of
6 whom also sit on its board. Designing, building, operating, and obtaining customers for a large,
7 regional, water treatment plant requires a different set of skills than needed to provide irrigation
8 water to farmers or golf courses. Even large, experienced, water utilities have stumbled, as did
9 the City of Tucson several years ago when it first began distributing treated CAP water to its
10 customers.

11 **7. How Would Customers Be Better Off With MWD's Proposal?** With Arizona-
12 American's proposal, all the capital costs for the White Tanks Plant will be funded by hook-up
13 fees. Any remaining rate increase would be moderate, needed only to recover variable plant
14 costs such as media, electricity, and other O&M costs. This is consistent with the principle of
15 cost causation. Customers responsible for new costs should bear those costs. Here, customer
16 growth is the major factor driving the need for the White Tanks Plant and other new water
17 infrastructure. Therefore, having these customers bear these costs through hook-up fees is
18 equitable.

19 The use of hook-up fees to fund new infrastructure, including water facilities is also
20 consistent with the practice of most water providers, public and private. In its Agua Fria District,
21 Arizona-American is currently charging builders a Water Facilities Hook-Up Fee of only \$1,150
22 for 5/8 x 3/4-inch meters, \$1,750 for 3/4-inch meters, \$2,875 for one-inch meters, with
23 increasing fees for larger meters. This is substantially less than builders are paying in similar
24 high-growth areas in Maricopa County. For example, in the City of Peoria, the current water
25 hook-up fee for 3/4 and one-inch meters is \$3,497. The City of Surprise is proposing new
26 development fees for Water Resources (\$3,447) and Drinking Water System (\$3,500) totaling
27 \$6,955 for new-home residential water customers with 3/4-inch meters. Finally, in Decision No.

1 68857, the Commission approved a rate-base reduction tariff for Arizona-American's Anthem
2 Water District. This tariff applies to all new connections and starts at \$3,000 for 5/8 x 3/4-inch
3 meters. The rate-base reduction tariff is on top of a \$765 per equivalent residential unit capacity
4 reservation charge.

5 MWD would instead have customers, current and new, bear all the costs of purchasing
6 treatment, including capital costs. This will require a major rate increase for Agua Fria
7 customers. Because of regulatory lag, it would further damage Arizona-American's finances,
8 unless some kind of deferral mechanism could be worked out to allow Arizona-American to
9 recover test-year treatment costs.

10 In Arizona-American's Agua Fria Water District, the Commission represents customers.
11 By contrast, as it has clearly purported, MWD represents landowners. MWD wants to avoid
12 hook-up fee increases that it believes would interfere with its ability to market real estate, even if
13 the new rates were consistent with Valley practice. As should be clear, MWD cares little, if at
14 all, about potable water rates. It is hard to see how Arizona-American's customers would be
15 better off with MWD's proposal. However, MWD should be given the opportunity to do so.

16 PROPOSED SCHEDULE

17 In its Application for Leave to Intervene, MWD promised that it "has no desire to cause
18 undue delay to the Commission's proceedings and it will act quickly in these matters."⁵ To that
19 point, MWD has offered nothing new to Arizona-American since negotiations broke off over
20 MWD's insistence on being insulated from all ownership risk. Arizona-American does believe
21 that the issues raised by MWD deserve a hearing, but expects the Commission to hold MWD to
22 its word. Arizona-American has begun the bid-solicitation process and, as part of that, is holding
23 an informational meeting with bidders next week, on Tuesday, December 5. As it has previously
24 stated, Arizona-American must award a bid early next quarter if it can have any hope of getting a
25 treatment plant built by May 2009. Arizona-American is willing to proceed with the process and

⁵ Application, p. 4, l. 9-10.

1 even select a bid-winner, but the selection must be contingent upon Commission approval of a
2 hook-up fee increase similar to what Staff recommended in its Staff Report. Therefore, Arizona-
3 American suggests the following procedural schedule:

- 4 • December 22, 2006 – MWD direct testimony filed. Arizona-American, Staff, and RUCO
5 identify sponsoring witnesses.
- 6 • January 12, 2007 – Responsive testimony by any party filed.
- 7 • Week of January 22, 2007 – Evidentiary Hearings.
- 8 • February 6, 2007 – Simultaneous briefs due.
- 9 • February 26, 2007 – Recommended Opinion and Order.
- 10 • March 13, 2007 – Open Meeting Consideration

11 Arizona-American also asks that MWD commit to respond to discovery within five calendar
12 days of receipt.

13 This is a tight schedule, but doable. Certainly, most of the initial burden will be on
14 MWD, but, as the late intervenor, MWD should bear the burden of not unduly delaying these
15 proceedings, and has promised to act quickly and not cause undue delay. This schedule will
16 allow MWD to have its issues to be heard as it has requested, without jeopardizing Arizona-
17 American's efforts to provide treated surface water to its Agua Fria customers by 2009 if the
18 Commission decides that Arizona-American's proposal, as modified by Staff, should be adopted.

19 One final request – If MWD is really serious about not wanting customers to suffer from
20 delay, it should in good faith commit to provide interim water supplies to Arizona-American in
21 sufficient quantities to protect present and future customers from water shortages until a regional
22 water treatment is completed. Most of these supplies are rarely, if ever, used, and Arizona-
23 American would be responsible for outfitting the wells so that they could provide potable water,
24 connecting them to our existing system, reimbursing MWD for any incremental costs, such as
25 electricity, incurred because of the wells' increased operation. If MWD will not grant this
26 public-interest request, then its true motives will be clear.

1 **REQUESTED RELIEF**

2 Arizona-American asks that the Administrative Law Judge set a procedural schedule that
3 will allow the Commission to conclude this matter at its regularly-scheduled Open Meeting on
4 March 13, 2007. A suggested schedule to accomplish this goal is provided above. As part of
5 that schedule, Arizona-American also asks that MWD file testimony supporting its position that
6 its proposal is superior to that offered by Arizona-American and that MWD's testimony answer
7 at least the following questions:

- 8 **1. What Will Be The Total Cost Of MWD's Treatment Facility?**
9 **2. When Could MWD Actually Bring Its Plant On Line?**
10 **3. How Should Arizona- American Supply Its Customers' Water Needs Until The**
11 **MWD Plant Came On Line And At What Cost?**
12 **4. Is MWD Now Willing To Accept Ownership Risks?**
13 **5. How Much Does MWD Intend To Charge Its Customers?**
14 **6. Is MWD The Best Entity To Provide Potable Water Treatment Services?**
15 **7. How Would Customers Be Better Off With MWD's Proposal?**

16 RESPECTFULLY SUBMITTED on November 29, 2006.
17

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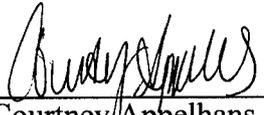
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