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ARIZONA WATER COMPANY



Docket No. W-1445A-02-0619

2002 RATE HEARING EXHIBIT NO. ____

For Test Year Ending 12/31/01

**PREPARED
REJOINDER TESTIMONY & EXHIBITS
OF
William M. Garfield**

EXHIBIT
A-3
Admitted

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BEFORE THE ARIZONA CORPORATION COMMISSION

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 EASTERN GROUP AND FOR
CERTAIN RELATED APPROVALS.

Docket No. W-01445A-02-0619

REJOINDER TESTIMONY OF WILLIAM M. GARFIELD

EXHIBIT
A-3

1 **I. INTRODUCTION**

2 **Q. WHAT ARE YOUR NAME, EMPLOYER AND OCCUPATION?**

3 A. My name is William M. Garfield. I am employed by Arizona Water Company (the
4 "Company" or "AWC") as President.

5 **Q. ARE YOU THE SAME WILLIAM M. GARFIELD THAT PREVIOUSLY**
6 **SUBMITTED DIRECT TESTIMONY AND REBUTTAL TESTIMONY IN**
7 **THIS MATTER?**

8 A. Yes, I am.

9 **II. OVERVIEW, PURPOSE AND EXTENT OF TESTIMONY**

10 **Q. WHAT IS THE PURPOSE OF YOUR REJOINDER TESTIMONY IN THIS**
11 **PROCEEDING?**

12 A. The purpose of my rejoinder testimony is to respond to certain surrebuttal
13 testimony submitted by the Arizona Corporation Commission's Utilities Division
14 Staff ("Staff") and the Residential Utility Consumer Office ("RUCO") in this rate
15 proceeding. Specifically, I will present the Company's rejoinder position with
16 respect to certain portions of the Pinal Creek Group matter, the effects of Staff's
17 tiered rate design, RUCO's position on higher than average rates of return for well
18 run water utilities and Staff's position on water system losses.

19 **III. RESPONSE TO SURREBUTTAL TESTIMONY OF STAFF**

20 **Q. DO YOU AGREE WITH MR. THORNTON'S SURREBUTTAL**
21 **TESTIMONY CONCERNING STAFF'S RATE DESIGN AND THE**
22 **RESULTING SUBSIDIES?**

23 A. No, I do not. Although Mr. Thornton states that it was not Staff's intent to provide
24 any subsidies beyond the lifeline rate, the fact remains that Staff's rate design will
25 result in subsidies from commercial, industrial, other non-residential customers,
26 and large meter customers to residential customers, as I previously testified in my

1 rebuttal testimony. Since Staff claims that it was not their intent to subsidize
2 customers other than through the lifeline rate, and since it is clear that there is
3 significant subsidization resulting from Staff's tiered rate design, Staff's rate
4 design should be rejected.

5 **Q. DO YOU AGREE WITH STAFF THAT A TEN PERCENT LOST WATER**
6 **VALUE SHOULD BE USED AS AN INDICATOR THAT THERE IS A**
7 **NEED TO EXAMINE WATER LOSSES MORE CLOSELY?**

8 A. No, I do not. The Company tracks water losses for all water systems and looks for
9 changes in water system water losses as well as volumes of lost water. Just
10 because a water system's water losses exceed ten percent (10%) does not
11 necessarily mean that additional actions, such as conducting a water audit or
12 instituting a more aggressive meter change out program are warranted.
13 Consideration of many case specific facts must be completed before such actions
14 are contemplated.

15 **Q. DO YOU AGREE WITH STAFF THAT TEN PERCENT (10%) AND**
16 **FIFTEEN PERCENT (15%) WATER LOSS VALUES ARE GUIDEPOSTS**
17 **WITHIN THE WATER INDUSTRY?**

18 A. No, and I do not agree with Staff or with the Arizona Department of Water
19 Resources that a ten percent water loss is an industry standard. Although the July
20 1996 article that Staff has included in its surrebuttal testimony refers to historically
21 developed water loss criteria of ten percent (10%) and fifteen percent (15%), the
22 article points out that water loss expressed as a percentage of water production is
23 inappropriate and many other factors should be considered.

24 Staff apparently has not kept pace with water loss control strategies in the
25 water industry and the factors by which water distribution system efficiency is
26 currently measured. Referring to the "Water Loss Control Manual" published in

1 2002, and which the American Water Works Association's Leak Detection and
2 Water Accountability Committee played a significant role in developing, the
3 current standard for measuring water system operating efficiency includes those
4 factors identified in my previous rebuttal testimony. See Garfield Rebuttal
5 Testimony Pages 24-25.

6 **Q. WHAT TYPE OF INFORMATION IS STAFF RECOMMENDING THE**
7 **COMPANY COMPILE CONCERNING WATER LOSS?**

8 **A.** Contrary to Staff's assertion that "all that Staff is requesting is that the Company
9 quantify, compile and present the pertinent information," (Surrebuttal Testimony of
10 Lyndon Hammon ("Hammon Surrebuttal") at Page 2 Lines 10-11), Mr. Hammon's
11 direct testimony provides a recommendation that the Company perform a water
12 audit and system analysis. Direct Testimony of Lyndon Hammon at Page 5 Lines
13 5-7. In addition, Staff also recommends that the Company be required to submit a
14 plan to the Director of the Utilities Division of the Commission outlining the
15 procedures, steps, and time frames to achieve acceptable water losses. Direct
16 Testimony of Lyndon Hammon at Page 6 Lines 1-4.

17 For those water systems with water losses above ten percent (10%), the
18 Company would then be required to submit a report, containing detailed cost
19 analyses and explanations why a water loss reduction to less than ten percent
20 (10%) could not be achieved. Lastly, such reports and water loss plans would be
21 submitted to the Director of Utilities, who would then have the authority to institute
22 a formal proceeding before the Commission to require modifications to the plans.
23 This would be true, despite the fact that the ten percent (10%) and fifteen percent
24 (15%) may not be new or unusual, as Staff points out, nor are they representative
25 of current industry standards or reflective of the facts surrounding each water
26 system in which water losses may be at or above ten percent (10%).

1 In sum, the Company previously identified a number of factors affecting
2 water losses demonstrating that the Company has a current water loss control
3 management plan in place. This is not to say that the Company objects to working
4 with Staff outside of this proceeding to address water loss by providing information
5 on the measures taken by the Company in reducing or maintaining water loss to an
6 acceptable level, providing copies of monthly water loss reports, etc. However, the
7 Company does object to being required to file reports and water loss control plans
8 as a precondition to approval of the Company's application to adjust rates in this
9 matter. Staff has not demonstrated that the Company's management of water loss
10 control is inadequate, but instead applies an arbitrary ten percent (10%) or fifteen
11 percent (15%) factor that is contrary to current water loss control methods and
12 practices. Absent such a demonstration, the Company's efforts to avoid and
13 minimize water loss do not require the regulatory micromanagement Staff
14 recommends in this rate case.

15 **Q. DO YOU AGREE WITH STAFF CONCERNING THEIR REQUIREMENT**
16 **THAT THE COMPANY FILE A CURTAILMENT PLAN WITH THE**
17 **COMMISSION WITHIN 120 DAYS FROM THE EFFECTIVE DATE OF A**
18 **DECISION IN THIS MATTER?**

19 A. The issue of curtailment tariffs is an industry-wide issue that should not be handled
20 in a piecemeal fashion, but the Company is willing to file a Company-wide
21 curtailment tariff.

22 **Q. DO YOU AGREE WITH STAFF THAT THE PROPOSED ADJUSTMENT**
23 **TO THE MIAMI POWER ADJUSTMENT WAS AN APPROPRIATE**
24 **ADJUSTMENT AND THAT THE COMPANY DID NOT ADEQUATELY**
25 **SUPPORT ITS POSITION?**

26 A. No, I do not. Staff has proposed adjustments relating to the Company's Miami

1 water system reducing the Company's allowable operating expenses by \$39,000
2 based on an amount calculated by Staff on the assumption that the Company will
3 be receiving the maximum amount of water under the PCG Settlement in the form
4 of free water delivered to the Company's Miami water system from wells owned or
5 controlled by the PCG. But that's only an assumption; it is not a fact. The
6 evidentiary standard of "known and measurable" cannot be met by the Staff's
7 direct or surrebuttal testimony on this point or by any of Staff's schedules since the
8 Staff's proposal is not based on "known and measurable" costs.

9 Besides the fact that the Staff has misinterpreted the PCG Settlement, they
10 are flatly incorrect concerning the provision of free water until October 2028. The
11 Company was unable to provide work papers or a schedule showing an alternative
12 proposal since there is no known and measurable cost information on which to
13 make any such proposal, making Staff's criticism unwarranted. See Hammon
14 Surrebuttal Testimony at Page 3 Lines 22-27. Nevertheless, the Company's
15 schedules included with its direct testimony provided cost information, including
16 that quantity of free water delivered to the Company's Miami water system by the
17 PCG for the 2001 test year. In that respect, the Company has met the burden of
18 proof on such cost information based on known and measurable data. In contrast,
19 the Staff has no known and measurable information on which to base its \$39,000
20 adjustment to lower allowable operating expenses for the Miami water system and
21 Staff's proposed adjustment should be rejected.

22 **IV. RESPONSE TO SURREBUTTAL TESTIMONY OF RUCO**

23 **Q. DO YOU AGREE WITH RUCO'S STATEMENTS CONCERNING THE**
24 **COMPANY'S CHARACTERIZATION OF THE CONSIDERATION**
25 **RECEIVED FROM THE PCG SETTLEMENT?**

26 **A. No, I do not. I provided information that confirmed that the consideration received**

1 by the Company, which includes replacement water and a monetary payment, were
2 provided by the PCG in exchange for a release of all losses, damages and liabilities
3 arising out of the Company's disputed claims some of which were referred to in
4 Paragraph 15 of the PCG Settlement. This information was taken directly from the
5 agreement itself and represents the factual information concerning the terms of the
6 settlement. Contrary to Mr. Rigby's surrebuttal testimony, the Company was not
7 attempting to provide any reasoning as to what any monetary payment or
8 consideration may have been based on, other than what the plain language of the
9 PCG Settlement provides.

10 **Q. DO YOU AGREE WITH RUCO'S CONTENTION THAT MIAMI SYSTEM**
11 **RATEPAYERS ARE ALSO EXPERIENCING DAMAGES AND THE**
12 **COMPANY SHOULD SHARE THE MONETARY PAYMENT WITH**
13 **THESE CUSTOMERS ON A 50/50 BASIS?**

14 **A.** No, I do not. RUCO fails to provide any evidence that the Miami system
15 customers have been experiencing damages. The fact of the matter is the Company
16 met the challenge of adding additional water supplies in capacities and at times that
17 additional supplies were needed, even when high quality drinking water supplies of
18 useable quantities were difficult to develop due to the local geology and
19 groundwater degradation in the Miami area. Contrary to RUCO's assertions, the
20 Company is sharing the benefits received from the PCG Settlement with its Miami
21 customers.

22 RUCO ignores the fact that Miami customers are already receiving tangible
23 benefits from the PCG Settlement, both in subsidized water supply costs and
24 increased and reliable water supplies. See Rejoinder Testimony of Ralph J.
25 Kennedy at Page 9 Lines 12-22; Rebuttal Testimony of William M. Garfield at
26 Page 14 Lines 18-21. The subsidized water supply costs, estimated at \$150,000 per

1 year will continue for at least five more years, even when the free water spigot is
2 turned off and the Company must pay the full cost of owning, operating and
3 maintaining water supply wells at costs equal to or greater than the current average
4 water supply costs for the 2001 test year. Customers have been receiving free
5 water in increasing capacities since 1998. The PCG Settlement provides a 600
6 gallon per minute drinking water supply through 2028, a sizeable benefit to the
7 Company's Miami system customers. Mr. Kennedy has estimated that the
8 minimum benefit of the PCG Settlement to Miami customers ranges from \$5
9 million to \$17 million depending upon the discount rate. See Kennedy Rebuttal
10 Testimony at 5.

11 RUCO is simply choosing to ignore these benefits in order to focus on one
12 part of the PCG Settlement, the monetary payment received by the Company.
13 When the PCG Settlement is viewed in the totality of the circumstances it is clear
14 that the ratepayers in the Miami system have and will continue to receive more
15 than their fair share of the benefits of the PCG Settlement, without the arrangement
16 recommended by RUCO (or Staff's suggested taking of all the benefits from the
17 Company).

18 **Q. IS RUCO'S RATIONALE FOR ITS RECOMMENDATION TO SHARE**
19 **THE MONETARY PAYMENT WITH THE CUSTOMERS ON A 50/50**
20 **BASIS BASED ON ANY PREVIOUS COMMISSION DECISION?**

21 A. No, not based on the facts presented in this matter. Contrary to RUCO's assertion
22 that ratepayers, as captive customers of an incumbent local monopoly are entitled
23 to share in gains received by utilities from the sale of assets (which does not apply
24 to this case), or for any other compelling reason, RUCO fails to cite any
25 Commission Decision that represents sharing of gains in any other instance other
26 than the sharing of gains on sale of assets. The Company has not sold any assets.

1 All assets that are in the Miami system rate base are necessary to provide water
2 service to the Company's Miami system customers. The matter cited by Mr.
3 Rigsby in Decision Number 66028 does not involve a sharing of a monetary
4 payment received by a utility as part of an overall comprehensive settlement of
5 disputed claims, losses, damages and liabilities arising out of water contamination.

6 That decision involved a case where a utility was required to pass along
7 ninety percent of the savings resulting from a new lower cost power supply
8 agreement with its customers. See Decision 66028 at Page 32 Lines 3-6. This was
9 not even a sharing of the gains resulting from a sale of assets, but simply reflected
10 a sharing of cost savings. In the present case, however, the Company has passed
11 on one hundred percent of the reduction in water supply costs received under the
12 PCG Settlement and will continue to pass such cost savings even after the free
13 water spigot is shut off.

14 **Q. BUT ISN'T RUCO JUST SAYING THAT THE SAME RATIONALE IN**
15 **THOSE OTHER DECISIONS, THAT THE RATEPAYERS PAID FOR THE**
16 **SOLD ASSETS, APPLIES HERE?**

17 **A.** This situation is different. First, there is the more obvious difference. In those cases
18 relied upon by RUCO, the utility sells the assets and has nothing else to share with
19 ratepayers. Here, we have already shared millions of dollars in savings and will
20 continue to do so for decades. As Mr. Kennedy explains, the \$1.4 million the
21 Company received is exceeded by the savings our ratepayers have and will
22 continue to realize. *See Kennedy Rejoinder at Pages 9-10.*

23 There is a more fundamental equity issue before the Commission in this
24 case. RUCO is quick to point out that the customers of any regulated water utility
25 are captive, without a choice in water providers. But, what RUCO fails to point out
26 is that accompanying the Company's exclusive right to provide water service in its

1 service area is the parallel requirement that the Company provide all of the water
2 service needs of its customers, which in Miami has been an extremely challenging
3 task for the Company in light of the water quality and quantity concerns expressed
4 above. While rates for service may include a depreciation component, the fact is it
5 is the Company's (not the customers') investment in plant that has assured the
6 Miami customers a safe and reliable water supply. No other entity has stepped
7 forward to ensure this community's water supply or to take appropriate action
8 when water supplies are impacted by other entities, such as what has happened in
9 the Miami area. Keep in mind that the monetary payment received by the
10 Company was income, properly reported in its annual reports to the Commission,
11 for which there was no sale of assets.

12 **Q. SO YOU DO NOT AGREE WITH RUCO THAT RATEPAYERS PAY FOR**
13 **UTILITY ASSETS, OR THAT A POLICY OF SHARING MONETARY**
14 **GAINS IN CASES SUCH AS THE PCG MATTER WOULD PROVIDE AN**
15 **INCENTIVE TO GO AFTER EVEN LARGER SETTLEMENTS IN THE**
16 **FUTURE KNOWING THAT IT WOULD BE REQUIRED TO SHARE THE**
17 **GAINS WITH RATEPAYERS?**

18 **A.** No, I do not. Contrary to RUCO's contention that ratepayers pay for assets, the
19 Company and its shareholders must pay and finance the cost of assets. That is why
20 the Company is allowed an opportunity to earn a reasonable return on its
21 investment. While ratepayers pay water rates that are designed to cover the
22 reasonable cost of providing water service, the customers do not pay for assets.
23 Perhaps RUCO has lost sight of the difference between a utility and its customers.
24 RUCO's logic is no more reasonable than the argument that a person who buys a
25 McDonald's hamburger is buying assets in the McDonald's Corporation. This
26 argument simply misses the mark.

1 Clearly, depriving a utility of the economic benefit of a settlement that also
2 confers significant long-term savings on the customers (as with the PCG
3 Settlement) would be a major disincentive for the utility to devote the considerable
4 time, effort, and resources (and money) required to aggressively pursue polluters.

5 **Q. DO YOU AGREE WITH RUCO'S CONTENTION THAT A RATE CASE IS**
6 **NECESSARY TO DETERMINE WHAT, IF ANY, ADDITIONAL SAVINGS**
7 **MIAMI RATEPAYERS MIGHT BE ENTITLED TO AS A RESULT OF**
8 **THE PCG SETTLEMENT AGREEMENT?**

9 A. No, for the same reasons I stated in my rebuttal testimony. In addition, Mr.
10 Kennedy has testified that the customer benefits of the PCG Settlement will be
11 received at least through 2028 and no further adjustment, as RUCO and Staff
12 mistakenly suggest, is justified or necessary for the Miami customers to receive
13 these benefits. See Kennedy Rejoinder at Pages 9-10.

14 **Q. DO YOU AGREE WITH RUCO'S CONTENTION THAT THE**
15 **MONETARY PAYMENT RECEIVED BY THE COMPANY, AS PART OF**
16 **THE PCG SETTLEMENT WILL RESULT IN A HIGHER RATE BASE**
17 **FOR THE COMPANY'S MIAMI WATER SYSTEM?**

18 A. No. The Company has already testified that the Company's customers will benefit
19 from avoided costs, such as the elimination of the need to invest capital in new
20 water supply wells, at least to the extent that 600 gallons per minute of water
21 supply capacity must be maintained by the PCG through October 2028. To the
22 extent that any additional investments are made by the Company in its Miami
23 water system to maintain adequate levels of service to the Company's customers,
24 they will be treated in the same manner as any other investment in the Company's
25 water systems.

26 Concerning RUCO's concerns on the future impact of the PCG Settlement,

1 the record already shows free water from the PCG in the 2001 test year, resulting in
2 very significant cost savings to the Company's Miami system customers. In
3 addition, RUCO will have an opportunity to review any future ratemaking impacts
4 at the time of the Company's next rate case, which will probably be driven by the
5 impact of arsenic treatment and compliance with the new arsenic MCL.

6 **Q. DO YOU AGREE WITH RUCO THAT WELL RUN UTILITIES SHOULD**
7 **NOT BE ENTITLED TO A HIGHER THAN AVERAGE RATE OF**
8 **RETURN WHEN COMPARED WITH UTILITIES THAT ARE POORLY**
9 **RUN?**

10 **A.** No, I do not agree with RUCO on this point. RUCO's argument is based on an ill-
11 conceived notion that there are only two types of utilities; those utilities that are
12 complying with the Commission's requirements and expectations, (i.e., well run
13 utilities) and those utilities that are not complying (i.e., poorly run utilities).
14 RUCO's point is that if you perform, you get a reasonable rate of return and if you
15 don't perform you are forced out of business by the Commission. In RUCO's
16 explanation, there doesn't seem to be any other performance standard upon which
17 you can distinguish between utilities that continue in the utility business. See
18 Rigsby Surrebuttal Testimony at 26-27.

19 Contrary to RUCO's characterization of the "continuing" and "non-
20 continuing" categories of utilities, however, there are many differences between
21 how utilities operate, some operating more efficiently, like Arizona Water
22 Company, and some operating less efficiently. RUCO recognizes that the
23 Company is well run and that its customers benefit from stable water supplies, safe
24 drinking water and lower costs as a result. For these reasons alone, well run water
25 utilities should be allowed a higher than average rate of return. The Commission
26 should approve a higher than average rate of return for the Company in this rate

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proceeding.

Q. DOES THIS CONCLUDE YOUR REJOINDER TESTIMONY?

A. Yes, it does, except that I wish to note that my silence on any issue raised or recommendation made by Staff or RUCO in the surrebuttal testimony should not be taken as the Company's acceptance of such issue or recommendation.

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