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BEFORE THE ARIZONA CORPORATION COMMISSION

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2007 APR 27 P 4: 06
AZ CORP COMMISSION
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IN THE MATTER OF THE APPLICATION OF) DOCKET NO. W-01303A-05-0718
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.)
)
)
)

**MARICOPA WATER DISTRICT'S
REPLY BRIEF**

Arizona Corporation Commission
DOCKETED
APR 27 2007
DOCKETED BY *nr*

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The Maricopa County Municipal Water Conservation District Number One, commonly known as the Maricopa Water District (“District” or “MWD”) submits its reply brief.

The District’s service area includes much of Arizona-American’s Agua Fria system. The District has provided surface water to its west valley service area for more than 75 years. It owns the Beardsley Canal and it created Lake Pleasant. It also has surface water rights for the Agua Fria River. By law, it must use those rights for the benefit of its landowners. The District also holds substantial amounts of land that are now worth \$260 million to \$300 million. These landholdings must also be used for the benefit of the District’s landowners. The District’s plan is to construct its own surface water treatment plant using funds from land sales. The District will use the plant to treat its own Agua Fria River water. The District also has a commitment from the City of Goodyear to treat the city’s CAP water. The District will also return a portion of any margin (profit) from the plant to its landowners as a credit against their water bill from Arizona-American. This is an important benefit, especially as Arizona-American will be filing yet another rate case in 2008. Arizona-American claims that it needs a large increase in hook-up fees to fund its own surface water plant. But the hook-up fee increase is not needed because Arizona-American can obtain subsidized treatment services from the District’s plant.

Staff recognizes that it is likely wasteful to build two separate plants, because one regional plant will be more efficient. The District has concerns about using Arizona-American’s plant, because the District must ensure that the District’s assets are used to benefit its landowners, not Arizona-American’s out-of-state shareholders. The District has therefore decided to build its own plant. It would not be just and reasonable to require increased hook-up fees when no fees are needed and when service is available from a more efficient, less expensive plant. Therefore, the District requests that Arizona-American’s Revised Application be denied.

1 **I. Arizona-American is requesting a massive rate increase.**

2 **A. Arizona-American's rate increase is not just and reasonable.**

3 There appears to be substantial confusion about the nature of this case. But upon close
4 examination the nature of this case is clear – this is a case about a massive rate increase. The
5 Commission has previously found, and Arizona-American admits, that hook-up fees are rates.¹
6 Arizona-American's request for a massive increase in hook-up fees is therefore a request for a
7 massive rate increase. RUCO's suggestion that this is merely a "financing" case is thus off the
8 mark.

9 Staff suggests that the Commission approve Arizona-American's proposal because it
10 seems like a "viable proposal."² However, viability is not the standard for evaluating rate
11 increases. The Arizona Constitution requires a more searching analysis, declaring that rates must
12 be "just and reasonable."³ As the Applicant, Arizona-American has the burden of proof to show
13 that its proposed massive rate increase is just and reasonable. The District's plant will have
14 lower construction costs, lower operating expenses, lower financing costs, and it will provide a
15 landowner credit to reduce consumer water bills.⁴ Further, the District's plant will not require
16 any new hook-up fees because it will ultimately be paid for by sales of the District's substantial,
17 valuable landholdings.⁵ Therefore, Arizona-American has not shown that its proposed rate
18 increase is just and reasonable.

19 Staff and RUCO both urge the Commission to turn a blind eye to the District's
20 advantages and consider only Arizona-American's proposal.⁶ It would be unprecedented for the
21 Commission to consider only the Applicant's side of the story in setting rates. In establishing

22 _____
23 ¹ Ex. D-17.

24 ² Staff Brief at 6:10.

25 ³ Arizona Constitution, Article XV § 3.

26 ⁴ See MWD opening brief at 9-12.

27 ⁵ Id.

⁶ Staff Brief at 3 ("Thankfully, none of MWD's suggested analysis is necessary or appropriate.");
RUCO Brief at 2 ("While all of this is very interesting, the Commission does not have to, nor
should it make a decision based on any of it.")

1 just and reasonable rates, the Commission has typically considered all of the evidence in the
2 record. It should do so here as well. Moreover, no party objected to the District's evidence as
3 not relevant.

4 RUCO claims that the District is requesting the Commission to "pre-determine" whether
5 Arizona-American's proposed plant is prudent.⁷ RUCO correctly explains that a prudence
6 determination is typically made in a rate case. However, the District has not requested a finding
7 of prudence or imprudence regarding either proposed plant. Instead, the District simply requests
8 that the Commission find Arizona-American has not met its burden of proving the proposed
9 hook-up fee increase is just and reasonable.

10 **B. Arizona-American's rate increase cannot be approved without a fair value**
11 **finding.**

12 The Arizona Constitution contains two core commands regarding rates – they must be
13 "just and reasonable" and they must be based on "fair value."⁸ Because a hook-up fee is a type of
14 rate, any hook-up fee increase must comply with these two commands. As discussed above,
15 Arizona-American has failed to prove that its request is just and reasonable. And no party has
16 presented fair value information in this case.⁹ Because there is no fair value information in the
17 record, the Commission cannot make a fair value finding, and it therefore cannot approve an
18 increased hook-up fee in this case.

19 Although the issue was discussed several times at the hearing, only Arizona-American
20 and the District addressed fair value in their briefs. Arizona-American's discussion amounted to
21 a single sentence stating that a hook-up fee increase "would be based on the fair-value finding for
22 Arizona-American's Agua Fria Water District in Decision No. 67093, dated June 30, 2004."¹⁰
23 Thus, Arizona-American appears to acknowledge that a fair value finding is necessary. But there
24

25 ⁷ RUCO Brief at 2.
26 ⁸ Arizona Constitution, Article XV, Section 3 (just and reasonable) and Section 14 (fair value).
27 ⁹ See MWD Brief at 15-19 for a more in-depth discussion of fair value.
¹⁰ Arizona-American Brief at 5:13-15.

1 are two fatal problems with Arizona-American's fleeting fair value proposal. First, the decision
2 mentioned by Arizona-American is not in the record, and the evidence supporting that decision is
3 also not in the record in this case. Second, even if was in the record, that decision was based on
4 2001 test year.¹¹ Six year old data is too stale to use in finding fair value, even under normal
5 circumstances. And Arizona-American makes clear that circumstances are not normal,
6 discussing at length the substantial, rapid growth it faces in the Agua Fria Division.¹² That
7 growth would have caused Arizona-American to build many new mains, wells, and other
8 facilities. Arizona-American's fair value must be quite different now than it was in 2001. But
9 we can not know how much different, because there simply isn't any fair value information in the
10 record.

11 **II. The Commission should not fear the District.**

12 Arizona-American suggests that if it does not get what it wants, it will be left in a
13 "terrible bargaining position,"¹³ resulting in high rates charged to Arizona-American for service
14 from the District's plant. RUCO and Staff voice similar concerns. Such fears are unfounded.
15 Arizona-American's Agua Fria customers are, in large part, the District's landowners. The
16 District's purpose is to serve those landowners. High rates would run contrary to that purpose,
17 because those rates would be passed on to the District's landowners in their water bills. The
18 District's General Manager, Mr. Sweeney, testified that the District is fully aware of this fact, and
19 that it has no reason to charge Arizona-American high rates.¹⁴ Mr. Sweeney also explained that
20 the District has no profit motive.¹⁵ Further, Mr. Sweeney explained that District has historically
21 provided – and continues to provide – subsidized, below cost utility services.¹⁶ Both history and
22 motivation demonstrate that Arizona-American's fears are unfounded.

23 _____
24 ¹¹ Decision No. 67093 (June 30, 2004) at 4:17.

25 ¹² See e.g. Arizona-American Brief at 15-16.

26 ¹³ Arizona-American Brief at 28-29.

27 ¹⁴ Tr. at 578-80.

¹⁵ Id.

¹⁶ Id.

1 In addition, the District is governed by an elected board. Any board that caused high
2 water rates would likely not survive the next election. In short, democracy works. The framers
3 of Arizona's Constitution understood this, which is why they excluded municipal corporations
4 like the District from the Commission's jurisdiction.¹⁷

5 Moreover, Arizona-American's supposed fears are contradicted by its own proposal.
6 Arizona-American's plan is dependent on the District transporting water through the District's
7 Beardsley Canal from the CAP canal many miles to the plant site.¹⁸ The District sets its own
8 rates for canal transport service. Arizona-American is just as much at the "mercy" of the
9 District's decisions regarding canal transport rates as it would be at the "mercy" of the District's
10 decision regarding surface water treatment rates. In both cases a critical service is provided by
11 the District, an entity not regulated by the Commission.

12 RUCO makes a similar argument – that "the Commission should not abrogate its
13 ratemaking authority to the District."¹⁹ Why would it be acceptable to "abrogate" authority over
14 canal transport rates but not surface water treatment rates? In both cases, the Commission is not
15 really abrogating anything – it will retain full authority over rates charged to Arizona-American's
16 customers. In both cases, the District's long history of low utility rates, its public purpose of
17 serving the landowners and the District's democratic structure make any concerns unfounded.

18 Moreover, it is common for a public service corporation to rely on outside, unregulated
19 entities for essential services. For example, Diamond Valley purchases its water from an
20 unregulated entity, the Prescott Valley Water District.²⁰ Likewise, Chaparral City Water
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23 ¹⁷ See Arizona Constitution, Article XV, Section 2 (excluding municipal corporations from the
24 definition of public service corporation); *Rubenstein Const. Co. v. Salt River Agricultural
25 Improvement & Power Dist.*, 76 Ariz. 402, 265 P.2d 455 (1954)(holding that special districts are
26 municipal corporations and are therefore not subject the Commission's jurisdiction).

25 ¹⁸ Tr. at 512-513 (Sweeney)(describing wheeling agreement); Tr. at 684 (Gross)(plant cannot
26 operate when Beardsley canal out of operation).

26 ¹⁹ RUCO Brief at 4.

27 ²⁰ See Decision No. 69338 (February 2, 2007).

1 Company buys 90% of its water from the Central Arizona Project.²¹ And Arizona Water
2 Company buys all the water for its San Manuel system from BHP Copper Company.²² In each of
3 those cases, the Commission has accepted dependence on an unregulated entity for water supply.
4 The District's long record of low-priced utility service indicates that the Commission should
5 have no concern with extending this practice to include the District.

6 The District also has committed that it will not just "walk away" from the project.²³ As a
7 public entity subject to the public records law, the District agrees that the Commission may
8 inspect the District's books and records. And the District will work with the Commission's
9 Customer Services Section regarding any customer complaints.²⁴

10 Finally, Arizona-American objects that the District did not provide a firm price for
11 treatment service. But although Arizona-American trumpets its own cost estimates as "quite
12 accurate"²⁵, Arizona-American has not provided the District with a firm price for treatment of
13 The District's surface water. More importantly, Arizona-American has not provided a firm price
14 for its own residential customers. They have no guarantee on operating expenses. Indeed,
15 Arizona-American even reserves the right to put the plant into rate base, which could
16 dramatically increase rates for residential customers.

17 **III. The District's plan best supports long-term groundwater conservation.**

18 Arizona-American claims that denial of its hook-up fee will result in the pumping of
19 billions of gallons of groundwater. It supports this claim though a back-of-the-envelope
20 "estimate" by its counsel. Arizona-American admits that its own expert would not testify as to
21 this or any other estimate.²⁶ Arizona-American's simplistic estimate would have been child's
22 play for its expert to calculate on the stand – but he did not do so. This estimate is mere
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24 ²¹ See Decision No. 68176 (September 30, 2005).

25 ²² See Decision No. 66849 (March 19, 2004).

26 ²³ Ex. D-46 at 2.

27 ²⁴ Tr. at 592-93.

²⁵ Arizona-American Brief at 12.

²⁶ Arizona-American Brief at 18-19.

1 conjecture that is not supported by record evidence. Moreover, Arizona-American's estimate
 2 appears to be based on an incorrect in-service date.

3 More importantly, Arizona-American's focus on near-term groundwater use is short-
 4 sighted. Arizona-American's future plans include use of the District's Agua Fria River water.²⁷
 5 That water will only be available from the District at the District's plant. If Arizona-American
 6 purchases treatment service from the District now, it will have a greater chance of obtaining the
 7 Agua Fria water in the future. And in the absence of this water, Arizona-American will likely
 8 eventually be forced back into heavy reliance on groundwater. Moreover, the District has 60
 9 groundwater wells.²⁸ If Arizona-American purchases from the District, the parties can work
 10 together to minimize the use of these wells. That opportunity will be lost if Arizona-American
 11 goes it alone and builds a separate plant.

12 Arizona-American's attempt to position itself as a champion of groundwater conservation
 13 is ironic. Arizona-American and its predecessor, Citizens, have no claim to such a title. For
 14 decades, they relied exclusively on groundwater in the Agua Fria District. For decades, they
 15 neglected to bring their CAP water to the Agua Fria District. In contrast, for 75 years MWD has
 16 provided surface water to its service area. MWD's name includes "water conservation" and it
 17 has attended to that responsibility for decades.

18 **IV. The plant will benefit all customers.**

19 Arizona-American admits that its plant will "benefit" all customers in its Agua Fria
 20 District.²⁹ Arizona-American estimates that Phase I(a) of its plant will be able to serve 30,000
 21 customers.³⁰ Arizona-American has 30,000 customers in its Agua Fria Division.³¹ And Arizona-
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 23

24 ²⁷ Tr. at 55; see also Arizona-American Brief at 9 (Arizona-American "hopes" it can use this
 25 water).

26 ²⁸ Ex. D-45 at 4.

27 ²⁹ Arizona-American Brief at 20.

³⁰ Tr. at 243.

³¹ Ex. S-2 at 1.

1 American will run the plant at full capacity “as soon as it is available for production.”³² Thus, at
2 the onset all customers will receive almost all their water from the plant. The plant will benefit
3 all customers, so it is not fair for only some customers (future customers) to pay for the plant.

4 **V. Arizona-American’s supposed harms are illusory.**

5 Arizona-American complains that it will be harmed by “regulatory lag” if it uses the
6 District’s plant. This is because treatment costs might not be immediately included in rates.
7 However, the same is true for Arizona-American’s own plant with respect to operating costs.
8 Further, Mr. Broderick agreed that this harm could be avoided in various ways.³³

9 Arizona-American also complains that a contract with the District may be considered a
10 capital lease.³⁴ But Arizona-American provides no citation to the record for this claim.
11 Moreover, to the extent this is a real concern, the District would be willing to work with Arizona-
12 American to try to structure any contract to avoid such a result. And in any event, the
13 Commission can always order Arizona-American to use a less harmful method of accounting.³⁵

14 **VI. Arizona-American’s engineering arguments are flawed.**

15 Arizona-American argues that the District lacks experience. But the District’s
16 engineering firm, Malcolm Pirnie, has unrivaled experience in just this sort of project. And the
17 District itself has considerable experience in building and operating large scale utility projects.
18 The Beardsley Canal and Lake Pleasant are examples.

19 Arizona-American reproduces Mr. Gross’s cost estimate and proclaims that its costs are
20 “firm” and “quite accurate” and in large part based on bids.³⁶ But Mr. Gross admitted on cross-
21 examination that many of the line items listed were estimates without firm bids.³⁷

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23
24 ³² Ex. D-5.

25 ³³ Tr. at 231-34.

26 ³⁴ Arizona-American Brief at 21.

27 ³⁵ See Financial Accounting Standards Board Statement No. 71.

³⁶ Arizona-American Brief at 12.

³⁷ Tr. at 132-36.

1 Arizona-American argues that the District's schedule is "unreliable."³⁸ But the District's
2 schedule is backed by the highly experienced, international engineering firm of Malcolm Pirnie.
3 Mr. Albu of that firm testified that the District's plant can be in-service by mid-
4 2010, not 2011 as assumed by Arizona-American.³⁹ He also explains that Arizona-American's
5 claims about permitting and regulatory issues are unfounded.⁴⁰

6 Arizona-American also claims that it will need \$12 million in new facilities if it uses the
7 District's plant. Apparently these costs include \$6 million for an additional pipeline and \$6
8 million in other costs. Arizona-American did not provide a cost estimate specific to these
9 costs.⁴¹ Moreover, Arizona-American did not use its own computer model of its system to verify
10 whether those costs are necessary.⁴² Nor did Arizona-American update its model to reflect
11 slower growth due to the slow down in real estate.⁴³ Arizona-American's model was the basis of
12 its master plan. Mr. Albu reviewed this master plan and explained why Arizona-American
13 would not need the additional pipeline.⁴⁴

14 This same \$12 million in extra costs figures prominently in Mr. Broderick's rate analysis.
15 Indeed, these costs seem to be a major driver of the "rate increase" claimed by Mr. Broderick.⁴⁵
16 But even if these costs exist, they need not be funded with equity as assumed by Mr. Broderick.
17 They could be contributed by developers. Or if the Commission is truly concerned about these
18 costs, the Commission could approve a hook-up fee to cover those costs. An extra \$12 million in
19 hook-up fees is surely better than the \$100 million in fees Arizona-American expects to collect
20 over the next 8 years under its proposal.⁴⁶

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22 ³⁸ Arizona-American Brief at 22.

23 ³⁹ Ex. D-44 at 6-8.

24 ⁴⁰ Id.

25 ⁴¹ Tr. at 124-28.

26 ⁴² Tr. at 695-98.

27 ⁴³ Id.

⁴⁴ Tr. at 400-406.

⁴⁵ Ex. A-7 at Ex. TMB-S1.

⁴⁶ Ex. D-32.

1 Arizona-American also suggests that purchasing treatment from the District would cause
2 operational control difficulties. Mr. Albu explains that this fear is baseless.⁴⁷

3 **VII. Response to Arizona-American's proposed relief.**

4 Arizona-American's brief contains six specific requests for relief.⁴⁸ These requests
5 should each be denied. First, Arizona-American requests approval of its hook-up fee. As
6 explained above, this request does not comply with the "just and reasonable" and "fair value"
7 requirements of the Arizona Constitution. Arizona-American's second and third requests are for
8 two accounting orders. As explained in the District's opening brief, these requests are
9 unprecedented and should not be granted. Arizona-American's fourth and fifth requests involve
10 Arizona-American being ordered to file various proposals in its 2008 rate case. Arizona-
11 American is free to make whatever proposals it wants in that case, but there is no reason for the
12 Commission to command such proposals be included. Moreover, Arizona-American's suggested
13 expense proposal is extremely unorthodox and contrary to traditional ratemaking. Finally,
14 Arizona-American requests that the Commission declare the District's plant imprudent. As
15 explained above, the Commission should not make any prudence or imprudence findings in this
16 case. Instead, the Commission should evaluate Arizona-American's proposal to determine if it is
17 just and reasonable, and if it is supported by fair value.

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26 ⁴⁷ Ex. D-44 at 9.

27 ⁴⁸ Arizona-American Brief at 5-6.

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1 **VIII. Conclusion.**

2 The District requests that Arizona-American's six requests for relief be denied, and that
3 the relief requested in the District's opening brief be granted.

4 RESPECTFULLY SUBMITTED this 27th day of April 2007.

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