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BEFORE THE ARIZONA CORPORATION COMMISSION

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2008 FEB 13 P 4: 30

AZ CORP COMMISSION
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Arizona Corporation Commission
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DOCKET NO. W-01303A-07-0209

6 IN THE MATTER OF THE APPLICATION OF
7 ARIZONA-AMERICAN WATER COMPANY
8 FOR A DETERMINATION OF THE CURRENT
9 FAIR VALUE OF ITS UTILITY PLANT AND
10 PROPERTY AND FOR INCREASES IN ITS
11 RATES AND CHARGES BASED THEREON
12 FOR UTILITY SERVICE BY ITS SUN CITY
13 WATER DISTRICT.

OPENING BRIEF

11 **I. INTRODUCTION**

12 The Arizona-American Water Company ("Arizona-American") is the largest, investor-owned
13 water utility in the State of Arizona serving approximately 131,000 customers. The Sun City Water
14 District ("Company") is Arizona-American's second largest water district serving approximately 23,
15 000 customers. The system covers roughly 18 square miles, including all of Sun City and
16 Youngtown, as well as small portions of the cities of Peoria and Surprise. The system was originally
17 two separate systems; the Sun City System and the Youngtown System. The Sun City System dates
18 back to 1960 and was owned by Citizen Utilities. In 1995, Citizens purchased the Youngtown
19 System and interconnected it with the Sun City System. Arizona-American purchased the Sun City
20 District from Citizens Utilities in 2002.

21 The Company filed an application for determination of the current value of its utility plant and
22 property and for increases in its rates and charges in 2007. The Company last received a rate increase
23 in 2004. Staff and the Company have been able to resolve many differences during the course of this
24 proceeding. The major issue remaining is the fire flow improvement project and the method of
25 funding for the project. The Company and Staff are in agreement on the necessity of the project and
26 the method of recovery by the Company. RUCO, while acknowledging that the improvements are a
27 matter of public safety, would nevertheless block the Company from any recovery.

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1 **II. DISCUSSION**

2 **A. Cost Of Capital**

3 **1. Staff recommends that the Commission adopt a capital structure of 61%
4 debt, 39% equity, that includes short term debt.**

5 Staff, the Company and RUCO agree that the cost of debt for the Company is 5.5%. The
6 Company has accepted Staff's cost of equity, 10.8%.¹ RUCO's position is that the cost of equity
7 should be 9.89%.² All parties disagree on the capital structure. Staff is recommending a capital
8 structure of 61% debt, 39% equity.³ The Company is proposing a capital structure of 58.6% debt,
9 41.4% equity. RUCO recommends a capital structure of 57.7% debt, 42.3% equity. Staff's
10 recommended capital structure includes short-term debt, while the Company and RUCO argue for the
11 exclusion of short-term debt. Staff's recommendation is reasonable and should be adopted.

12 Arizona Administrative Code ("A.A.C.") R14-2-103, Schedule D-2 sets forth what should be
13 included in a rate case application filing. The requirements include a listing of an applicant's short-
14 term debt as a component of the cost of capital. It would seem that the Rule R14-2-103 contemplates
15 the inclusion of short-term debt in an applicant's capital structure. The Company cites Decision No.
16 68310 in support of its request to exclude short-term debt.⁴ Decision No. 68310 dealt with arsenic
17 cost recovery mechanisms and did not establish a cost of capital finding.⁵ But Decision No. 68310
18 seems to contemplate that short term debt is to be included. Decision No. 68310 ordered the
19 Company to file an equity plan to achieve and maintain an equity ratio between 40 and 60% of total
20 capital. In ordering paragraph number 4 at page 15, the Commission clearly included short-term debt
21 in the capital structure.

22 Contrary to the assertions by the Company that Staff is seeking to depress the Company's
23 equity ratio, Staff believes that the inclusion of short-term debt in the Company's capital structure
24 gives a clearer picture of the Company's financial position. Staff would urge adoption of its proposed
25 capital structure.

26 ¹ (Broderick Rebuttal Test., Ex. A-4 at 1).

27 ² (Tr. at 747:6-7).

28 ³ (Irvine Surreb. Test., Ex. S-17 at 2).

⁴ (Broderick Rebuttal Test., Ex. A-4 at 4).

⁵ Dec. No. 68310, Dockets No. W-01303A-05-0280, WS-01303A-02-0867, WS-01303A-02-0869, WS-01303A-0870
(Consolidated), (November 14, 2005).

1 **B. Revenue Requirement Issues/Rate Design**

2 **1. Staff recommends that the Commission adopt an Original Cost Rate Base**
3 **of \$25, 295,921.**

4 The Company and Staff have reached agreement on numerous adjustments recommended by
5 Staff. The Company has accepted Staff's position regarding Original Cost Rate Base: \$25,295, 921.⁶
6 RUCO's rate base recommendation, according to RUCO's witness, Tim Coley, is \$25,356,828.⁷ The
7 Company has accepted Staff's recommendation concerning plant in service and accumulated
8 depreciation.⁸ RUCO accepts the Company's requested gross utility plant in service and accumulated
9 depreciation.⁹ Staff and the Company have slight differences on the calculation of property taxes,
10 which in turn affects income taxes because of a difference in the rate of return. RUCO's position on
11 rate base includes an allowance for working capital. RUCO also had numerous adjustments relating
12 to the Company's operating expenses on property taxes ¹⁰, revenue annualization ¹¹, miscellaneous
13 expenses¹², and the Company's achievement incentive plan.¹³ Neither the Company nor Staff
14 accepted the adjustments proffered by RUCO.

15 The Company has accepted the Staff's recommendation on rate design,¹⁴ with the exception
16 of an addition for the low-income assistance program.

17 **2. Staff generally supports the proposed Low Income Assistance Program,**
18 **with reservations.**

19 The Company has proposed a Low Income Assistance Program ("LIAP" or "Program") as a
20 part of its rate filing. The proposed Program is an alternative to the low income assistance program
21 that was approved by Decision No. 67093, but was never implemented. The LIAP is designed to
22 assist eligible ratepayers in the Sun City Water District by offering a 50% discount on the basic
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25 ⁶ (Tr. at 577:17-22).

26 ⁷ *Id.* at 818:21.

27 ⁸ *Id.* at 577:17-22.

28 ⁹ *Id.* at 819:11-15.

¹⁰ *Id.* at 825:8-17.

¹¹ *Id.* at 825:18-25-826:22.

¹² *Id.* at 826:23-827:20.

¹³ *Id.* at 828:21-829:8.

¹⁴ *Id.* at 356:7-10.

1 service charge.¹⁵ To be eligible, one must be a fulltime Sun City Water District resident, over the
2 age of 65, with an annual income that cannot exceed 150% of the federal poverty income guidelines.

3 The Company will limit the initial enrollment to 1000 persons.¹⁶ The Company indicated that
4 certain aspects of the LIAP were designed to address the concerns proffered by RUCO, that any
5 program proposed by the Company identify an appropriate set of customers, create material benefit
6 for those who qualify, be effectively administered and not be overly burdensome on non-
7 participants.¹⁷

8 Ms. Datig's organization \$1 Energy, would administer the program on behalf of the
9 Company. The fee for administration is \$30,000.¹⁸

10 The Company acknowledged that the LIAP is a discretionary project, not required by any
11 Commission rule or statute.¹⁹

12 Staff is generally supportive of the Company's proposed LIAP.²⁰ Mr. Igwe testified that Staff
13 is concerned about the debt to benefit ratio.²¹ However, because of the administrative costs
14 associated with the Program, Staff would suggest that the Company explore a more cost effective
15 way to administer the program.²²

16 C. Fire Flow Improvement

17 1. Staff recommends approval the proposed Fire Flow Improvements to meet 18 the minimum standards as recommended by the Task Force.

19 Decision No. 67093 ordered Arizona-American to form a Fire Flow Task Force to be
20 comprised of members including, but not limited to, a representative of the Company's Arizona
21 management team, representatives from Youngtown and Sun City, a representative of the Sun City's
22 Taxpayers' Association, a representative of the Recreation Centers of Sun City and representatives
23 from the fire departments serving Youngtown and Sun City ("Task Force").²³ The purpose of the

24 ¹⁵ (Datig Direct Test., Ex. A-1 at 5, 7-8).

25 ¹⁶ (Broderick Direct Test., Ex. A-3 at 11).

26 ¹⁷ (Coley Direct Test., Ex. R-5 at 31).

27 ¹⁸ (Tr. at 97:8).

28 ¹⁹ *Id.* at 95:1-8.

²⁰ *Id.* at 971:11-14.

²¹ *Id.* At 971:14-22.

²² *Id.* At 971:19-22.

²³ Decision No. 67093, Dockets No. WS-01303A-02-0867, WS-01303A-02-0868, W-01303A-02-0869 (Consolidated), (June 30, 2004).

1 Task Force was to determine if the water production capacity, storage capacity, water lines, water
2 pressure and fire hydrants of Youngtown and Sun City were sufficient to provide fire protection
3 capacity that is desired by each community. The Task Force was to report its findings and proposed
4 plan of action to the Commission by May 30, 2005. The Task Force retained Brown & Caldwell to
5 model the system and recommend improvements.²⁴

6 In 2004, the Task Force determined that \$3.1 million of capital investment is required to
7 upgrade the Sun City Water District's systems to meet the desired fire protection standards.²⁵ The
8 Task Force also recommended that the minimum standard for fire flow be 1000 GPM for residential
9 and 1500 GPM for commercial and multi-family.²⁶ For hydrant spacing, the Task force
10 recommended 660 feet.²⁷ Through its testimony, the Company revised the initial estimate, because of
11 inflation, the failure of the original estimate to allow for contingencies and engineering costs during
12 construction and the Company's internal cost and the passage of time, and determined that an
13 investment of more than \$5 million is needed.²⁸ Staff's position is that \$5.1 million is "on the high
14 range"²⁹ and that there may be ways for the Company to reduce its cost, perhaps the labor
15 component.³⁰

16 The Company witness, Joseph Gross, acknowledged that in the design of water systems, the
17 Company consults with the municipality and the fire marshal of that municipality for standards
18 relating to fire flow and hydrant spacing.³¹ Mr. Gross also acknowledged that the standards for fire
19 flow recommended by the Task Force were inconsistent with the standards of other municipalities he
20 is familiar with and the standards used by the Company in its design of water systems.³²

21 The Company, during the testimony of Mr. Gross acknowledged that A.A.C. R14-2-407
22 requires that a water utility maintain standard delivery pressure of 20 pounds per square inch ("PSI")
23 at the customer's meter or point of delivery.³³ Mr. Gross further testified that it would not be

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²⁴ (Brown & Caldwell Fire Flow Study, Ex. A-13; tr. at 325:19-326:8).

25 ²⁵ *See id.*

26 ²⁶ (Tr. at 112:15-18).

27 ²⁷ *Id.* at 112:19-20.

28 ²⁸ (Gross Rejoinder Test., Ex. A-2 at 4-5; *see also* tr. at 122:9-124:13).

29 ²⁹ (Tr. at 938:6-7).

30 ³⁰ *Id.* at 937:25-938:6.

31 ³¹ *Id.* at 112:21-113:1.

32 ³² *Id.* at 113:11-19.

33 ³³ *Id.* at 158:9-14.

1 possible, based on the modeling found in the Task Force Report, to maintain the 20 PSI and delivery
2 1500 GPM in the areas that have insufficient fire flow. The Company's position is that the project is
3 discretionary,³⁴ in that there is no specific Commission rule that requires fire flow, although the
4 Company acknowledged there are municipal ordinances that require adequate fire flow as well as the
5 International Fire Code of 2003 that set forth standards with regards to fire flow.³⁵ Further support is
6 found under A.A.C. R14-2-606 (H). A.A.C. R14-2-606H provides that "[t]he Company may install
7 main extensions of any diameter meeting the requirements of the commission or any other public
8 agencies having authority over the construction and operation of the water systems and mains."
9 Although this rule deals with main extension agreements, its purpose is also relevant to existing
10 mains. Staff believes that this rule gives the Company the discretion to upgrade the system to meet
11 fire flow requirements.

12 **2. The recommended fire flow improvements are a matter of public safety**
13 **and should be approved.**

14 Staff views the fire flow improvements as a matter of public safety. Mr. Igwe testified that
15 "(b)ased on the Task Force Report, the proposed fire flow capital improvements seem imperative for
16 public safety in Sun City's Water District's certificated area³⁶. Even RUCO, despite their opposition
17 to the fire flow recovery mechanism and their characterization of fire hydrants as "amenities"³⁷
18 seemingly acknowledges that adequate fire flow is a matter of public safety.³⁸

19 The Town of Youngtown testified that the Sun City Water District was deficient in the
20 number of hydrants and that the lack of hydrants could impact the ability of the fire department to
21 protect life and property within the Sun City Water District.³⁹ Fire Battalion Chief Hank Oleson
22 testified of a fire in which a four-plex burned because one of the two fire trucks assigned to battle the
23 fire was searching for a water supply and was thus unavailable to assist in attacking the fire.⁴⁰

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26 ³⁴ (Broderick Direct Test., Ex. A-3 at 8).

³⁵ (Tr. at 173:11-16).

27 ³⁶ (Igwe Direct Test., Ex. S-21 at 6).

³⁷ (Tr. at 618:14-16, 625:21-23).

28 ³⁸ *Id.* at 618:12-14; 625:18-21.

³⁹ *Id.* at 216:25-218:3.

⁴⁰ *Id.* at 218:4-219:6.

1 Battalion Chief Oleson was of the opinion that the fire flow improvements are necessary for public
2 safety.⁴¹

3 Certain statements made during the Public Comment session seemed to indicate that there is a
4 perception that only Sun City Water District ratepayers that reside in certain areas of Youngtown
5 would be the only beneficiaries. Testimony from the Company as well as Staff indicated that is not
6 true. Company witness Brad Cole testified that more customers would benefit on the Sun City side
7 of the Sun City Water District than in Youngtown portion of the water district.⁴² Mr. Cole also
8 testified that there are also portions of the city of Peoria that will benefit as well. The Company
9 appeared distressed by the comments characterizing the fire flow improvements as Youngtown
10 improvements and Sun City paying for it, saying, "I hate to even get into that discussion, because this
11 is one water system to us. We don't follow political boundaries."⁴³ Mr. Broderick testified that
12 existing fire flow plant, like fire hydrants are already in the rates are shared by all in the Sun City
13 Water District.⁴⁴ He further testified that there is no rate difference for those ratepayers that are
14 currently receiving inadequate fire flow.⁴⁵ Mr. Cole testified that, as an example, if a well were
15 added in Youngtown, it would benefit everybody in that general area.⁴⁶

16 Staff witness Dorothy Hains testified that there could be additional benefits to the water
17 system beyond fire flow. Ms. Hains stated that the replacement of the mains would be replacing old
18 pipes that could be leaking and thus reduce water loss.⁴⁷

19 Both Staff and the Company reject the arguments that payment for the fire flow
20 improvements would result in a "subsidy" by Sun City customers for Youngtown improvements. The
21 Company testified that it doesn't think that subsidies exist in the instance or within a single tariffed
22 zone.⁴⁸ The Company doesn't calculate the cost of service for Youngtown, for Sun City or Peoria or
23 Surprise. As stated earlier, the project contemplates more work on the Sun City side and not
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25 ⁴¹ *Id.* at 241:16-18.

26 ⁴² *Id.* at 564:9-12.

27 ⁴³ *Id.* at 567:9-11.

28 ⁴⁴ *Id.* at 375:13-376:12.

⁴⁵ *Id.* at 376:13-17.

⁴⁶ *Id.* at 567:17-19.

⁴⁷ *Id.* at 958:7-19.

⁴⁸ *Id.* at 404:7-13.

1 Youngtown's side of the Sun City Water District, and Staff and the Company have both testified that
2 there are other benefits besides improved fire flow.

3 Improving fire flow will allow all citizens of the Sun City Water District to receive the same
4 level of service. A.R.S. § 40-334 (B) provides, that no public service corporation shall establish or
5 maintain any unreasonable difference as to rates, changes, service facilities or in any other respect,
6 either between localities or between classes of service. The Company testified that because of the
7 inadequate fire flow, not all customers are receiving the same level of service.⁴⁹ Staff believes the
8 improvements to be necessary to provide the same level of service to all ratepayers within the Sun
9 City Water District.⁵⁰

10 Arizona Revised Statute § 40-336 provides that "[t]he commission may by order rule or
11 regulation, require every public service corporation to maintain and operate its line, plant, system,
12 equipment and premises in a manner which will promote and safeguard the health and safety of its
13 employees, passengers, customers and the public..." A.R.S. § 40-361(B) also provides "[e]very
14 public service corporation shall furnish and maintain such service, equipment and facilities as will
15 promote the safety, health, comfort and convenience of its patrons, employees and the public as will
16 be in all respects adequate, efficient and reasonable." Staff believes these two statutes give the
17 Commission the discretion to approve use of ratepayer funds for fire flow improvements.

18 The project is discretionary in the narrow sense that there is no specific Commission rule
19 mandating it.⁵¹ Staff acknowledges that the Fire Flow Improvement Project requires a major
20 investment by the Company. Staff believes that the Fire Flow Cost Recovery Mechanism ("FCRM")
21 is the preferable method to pay for such improvements, and that such improvements are in the public
22 interest because the improvements will help protect life and property.

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28 ⁴⁹ *Id.* at 197: 10-14.
⁵⁰ *Id.* at 983:1-4.
⁵¹ *Id.* at 384: 17-21.

1 **3. Staff recommends approval of a Fire Flow Recovery Mechanism as an**
2 **appropriate method to allow recovery of the cost of the fire flow**
3 **improvement project.**

4 The Company testified that should there be broad community support for the Fire Flow
5 Improvement Project, the Commission should “depart from traditional ratemaking”.⁵² The Company
6 developed and mailed a survey to its residential customers as a way to gauge public support for the
7 Fire Flow Improvement Project. The Company’s witness Tom Broderick testified that the survey
8 was mailed, as a separate mailing, to all residential customers of record.⁵³ The survey contained 2
9 questions. The first question was: “Yes, I support improving fire hydrant flows in the Sun City Water
10 District or No, I do not support improving fire hydrant flows.” The yes response was calculated as
11 nearly 59% of responses received. The second questions was: “Yes I am willing to pay in my water
12 bill for the cost of improving fire hydrant flows in Sun City Water District so long as the Arizona
13 Corporation Commission finds the costs reasonable or No, I am not willing to pay for the proposed
14 fire hydrant flow improvements in a my water bill.” The yes rate was nearly 51%.⁵⁴ During the
15 public comment session, the Company learned that perhaps some residents did not receive the survey.
16 ⁵⁵ The Company stated that it mailed surveys to property management companies or home owners
17 associations (“HOA”), but has no way of knowing if a property management firm or the HOA
18 distributed those to its residents.⁵⁶ It appears that there is community support for fire flow
19 improvements; however it is the Company’s position⁵⁷ as well as the position of the Town of
20 Youngtown,⁵⁸ that while public opinion is important, it is not controlling. Additionally, the
21 Company sponsored two public meetings in Sun City and Youngtown to review the details of the Fire
22 Flow Project.⁵⁹

23 The Company proposed a surcharge similar to the arsenic surcharge as a method to recoup the
24 capital cost associated with the fire flow improvement project.⁶⁰ Normally, Staff would be opposed

25 ⁵² (Broderick Direct Test., Ex. A-3 at 10).

26 ⁵³ (Tr. at 364: 12-23).

27 ⁵⁴ See Broderick Rejoinder Test., Ex. A-5 at 2.

28 ⁵⁵ (Tr. at 370: 18-22).

⁵⁶ *Id.* at 371:2-23.

⁵⁷ *Id.* at 373:18-22.

⁵⁸ (LeVault Surreb. Test., Ex. Y-5 at 4).

⁵⁹ (Broderick Rebuttal Test., Ex. A-4 at 8).

⁶⁰ (Broderick Direct Test., Ex. A-3 at 4-5).

1 to a request to approve a mechanism to allow recovery of plant investment outside of a rate
2 proceeding, but because of the public safety impact, the significant cost and the community support,
3 Staff supports a surcharge mechanism.⁶¹

4 Staff made changes to the Company's proposed fire flow recovery surcharge mechanism.
5 Staff recommended a procedural format similar to the Arsenic Cost Recovery Mechanism ("ACRM")
6 that was approved in Decision No. 66400.⁶² Further Staff recommended an earnings test for the
7 Company's proposed step increases. An earnings test would enable the Commission to determine if
8 the Sun City Water District is over earning its approved rate of return at the time it files for each step
9 increase.⁶³ Staff's purpose in recommending changes to the Company's proposal was to insure that
10 Staff and any intervenors would have an opportunity to thoroughly assess the each step filing for the
11 surcharge.⁶⁴

12 Under the proposed FCRM, the Company would file various schedules that include but are
13 not limited to, a current balance sheet, a current income statement, an earnings test schedule, a rate
14 review schedule, a revenue requirement calculation, a surcharge calculation, an adjusted rate base
15 schedule, a CWIP ledger, a calculation of the allocation factors, a bill analysis, and an
16 implementation plan for the surcharge.⁶⁵ Staff would have 45 days to review the schedules and make
17 its recommendation. If there are disagreements, a hearing, on an expedited schedule, can be
18 requested.

19 Contrary to the assertion that the procedural aspects of the FCRM would not allow Staff the
20 same scrutiny as in a full rate case, Staff testified that because of the singleness of the focus, Staff
21 would actually be able to scrutinize the Company's filings more closely.⁶⁶ Company witness Tom
22 Broderick acknowledged, under questions from Administrative Law Judge Rodda, that the scrutiny
23 under the FCRM could be stronger than that in a rate case because Staff would review only the work
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26 ⁶¹ (Igwe Direct Test., Ex. S-21 at 6).

27 ⁶² Decision No. 66400, Docket No. W-01445A-00-0962 (October 14, 2003).

28 ⁶³ (Igwe Direct Test., Ex. S-21 at 9).

⁶⁴ *Id.*

⁶⁵ *Id.* at 10-11.

⁶⁶ (Tr. at 970: 3-971:4).

1 that was done for that particular step and not the entire system, as in a rate case.⁶⁷ The Company
2 accepted Staff's conditions concerning the processing of the FCRM step increases.⁶⁸

3 **4. The proposed FCRM is not similar to the method of recovery approved**
4 **for the Paradise Valley District and is a more acceptable method in terms**
5 **of impact to the ratepayer.**

6 During the hearing, the Company and Staff testified as to why the surcharge recommended in
7 this case differs from the methods approved in the Company's Paradise Valley case.⁶⁹ There are
8 several differences that make the FCRM preferable.

9 In Paradise Valley, because the recovery of costs are by an Accounting Order⁷⁰, there is no
10 physical review of the facilities or auditing review of the invoices until the next rate case.⁷¹ The
11 Paradise Valley project is funded as contribution in aid of construction ("CIAC"). The rate impact is
12 greater because of the high block surcharge as well as the public safety surcharge. There is no
13 earnings test because the surcharges are CIAC, so there is no impact on earnings.

14 The FCRM proposed in the case would require physical plant review and auditing of invoices
15 at every step filing. The Company cannot change the amount of the surcharge until it makes a step
16 filing and the Commission approves it. There is an earnings test proposed, and the surcharge would
17 be recorded as revenue.⁷²

18 The proposed surcharge would have a small effect on rates. Company witness Tom Broderick
19 testified that the estimated cost for year 2010 is 3.5 cents per thousand gallons, for year 2011, a total
20 cost of 7.4 cents per thousand gallons, for year 2012, 11.4 cents per thousand gallons; and for year
21 2013 and beyond roughly 17.4 cents per thousand gallons.⁷³ The Company in its late filed exhibit
22 revised the numbers slightly, in year 2009, 3.4 cents per thousand gallons; in year 2010, 7 cents per
23 thousand gallons; in year 2011 10.9 cents per thousand gallons and in year 2012, 15.5 cents per
24 thousand gallons.⁷⁴ The Company calculated that at median consumption level of 6500 gallons per
25 month, in year 2009 the rate would be rise to \$15.16 per month, from \$14.94; in year 2010, the

25 ⁶⁷ *Id.* at 457: 6-16.

26 ⁶⁸ (Broderick Rebuttal Test., Ex. A-4 at 14).

27 ⁶⁹ Decision No. 68858, Dockets No. W-01303A-05-0405, W-01303A-05-0910 (Consolidated), (July 28, 2006).

28 ⁷⁰ *Id.* at 32.

⁷¹ (Tr. at 488: 23-489:1).

⁷² *Id.* at 489:1-490:10.

⁷³ *Id.* at 444:19-24.

⁷⁴ (Average Annual Surcharge Bill Impact, Ex. A-15).

1 monthly bill would rise to \$15.40 from \$14.94; in year 2011, the monthly bill would rise to \$15.65
2 from \$14.94 and in year 2012, the monthly rate would increase to \$15.95 from \$14.94.⁷⁵ With an
3 average consumption of 8500 gallons, in year 2009, the monthly rate would increase to \$17.67 from
4 \$17.38; in year 2010, the monthly rate would increase to \$17.96 from \$17.38; in year 2011 the
5 monthly rate would increase to \$18.29 from \$17.38; and in year 2012 the monthly rate would
6 increase to \$18.67 from \$17.38.⁷⁶

7 Staff, in its late-filed exhibit, calculated the impact based on 6500 gallon median usage to be 9
8 cents per thousand gallons in year 2009; 23 cents per thousand gallons in year 2010; 35 cents per
9 thousand gallons in year 2011 and 52 cents per thousand gallons in year 2012.⁷⁷ For the average
10 consumption; 12 cents per thousand gallons in 2009; 29 cents per thousand gallons in 2010, 45 cents
11 per thousand gallons in 2011 and 67 cents per thousand gallons in 2012.⁷⁸ Staff, testified, that under
12 the concept of gradualism, the FCRM would be a way to avoid rate shock.⁷⁹

13 There was disagreement between Staff and the Company concerning the cost estimates for the
14 Fire Flow Improvement Project. The Company's witness, Joseph Gross, testified that the cost for the
15 project would be an estimated \$5.1million. Staff's witness, Dorothy Hains, testified that Staff
16 estimated the cost at \$2.7 million but acknowledged that Staff's estimate could be affected and
17 subject to change because of contingencies such as rising material costs.⁸⁰ However , the purpose of
18 the estimate is for public disclosure; the FCRM will allow monitoring of the costs of the project along
19 with the possibility of some disallowance of some cost. The FCRM will provide a form of protection
20 against exorbitant costs.

21 Company and Staff testified concerning alternative ways to pay for the Fire Flow
22 Improvement Project. One suggestion, to let Youngtown pay for the project was, according to the
23 testimony of the town and Staff's position in Paradise Valley, prohibited under the Gift Clause of the
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26 ⁷⁵ *Id.*

27 ⁷⁶ *Id.*

28 ⁷⁷ (Average Annual Surcharge Bill Impact, Ex. S-23).

⁷⁸ *Id.*

⁷⁹ *Id.* at 974:6-8).

⁸⁰ *Id.* at 936-38.

1 Arizona Constitution. Assuming that the Gift Clause is not implicated, Youngtown does not have an
2 effective mechanism for raising the money.⁸¹

3 Youngtown Mayor LeVault testified that he believed that the Gift Clause would prohibit
4 Youngtown from making improvements to a system that the Town does not own.⁸²

5 The Gift Clause, Article 9, Section 7 of the Arizona Constitution provides as follows:

6 Neither the state, nor any county, city, town, municipality, or other
7 subdivision of the state shall ever give or loan its credit in the aid of, or
8 make any donation or grant, by subsidy or otherwise, to any individual,
9 association, or corporation, or become a subscriber to, or a shareholder
10 in, any company or corporation, or become a joint owner with any
11 person, company, or corporation, except as to such ownerships as may
accrue to the state by operation or provision of law or as authorized by
law solely for investment of the monies in the various funds of the
state.

12 The Gift Clause would preclude the ability of the town to make improvements to a system
13 that it does not own and turn ownership of such improvements to the Company. Further the Town
14 indicated that it does not have bonding authority to raise the money, the Town has no primary
15 property tax and that the growth is such that raising sales tax would not provide much money.⁸³ Even
16 if the Youngtown were to raise the money, it would not solve the problem of the violation of the Gift
17 Clause.

18 The Company testified that it also believes that the Gift Clause requires that assets contributed
19 by a municipality to a private entity must not also have a private use. The Company testified that fire
20 hydrants have multiple uses. Staff is also of the opinion that the Gift Clause would prohibit
21 Youngtown from paying for the improvements.

22 There is no other realistic method to accomplish the Fire Flow Improvement Project. The
23 Company testified that there is no entity that stands ready to make the investment necessary to fund
24 the fire flow improvement projects.⁸⁴

27 ⁸¹ *Id.* at 279:8-13.
28 ⁸² *Id.* at 279:13-19.
⁸³ *Id.* at 279: 8-13.
⁸⁴ (Broderick Direct Test., Ex. A-3 at 7).

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5. An Accounting/Deferral Order would delay the recovery and increase the costs to ratepayers.

Questions were raised during the hearing on whether an Accounting Order would be a method to fund the improvement project. Staff felt that the disadvantage of an Accounting Order would be that costs would be aggregated for recovery in a future proceeding.⁸⁵ Mr Igwe, on behalf of Staff, further testified that the amount of a future rate increase would be more should all the cost be deferred to a rate case.⁸⁶ The Company testified that a disadvantage to an Accounting Order was that such an order would ultimately result in higher rates later. An Accounting Order would not give the Company the necessary direction on how to structure the Fire Flow Improvement Project, i.e. what part of the project should be done first?⁸⁷

6. RUCO's position should be disregarded.

While laudable in its attempts to protect the ratepayers, RUCO's position with respect to the Fire Flow Improvement Project should be disregarded. RUCO testified that while it acknowledges the public safety aspect of the project, the costs should not be born by the ratepayers. RUCO admitted in its testimony that it does not like to support programs that increase the burden on ratepayers and are discretionary; it supported the DSM project,⁸⁸ which does a cost to ratepayers and has no state or federal mandate. RUCO took the position that this fire flow project improvements should not be placed in rate base, while admitting that fire flow related plant is already in rate base in the instant case as well as in the rate base of most other water companies in the state.⁸⁹ If the Commission were to adopt RUCO's position and not allow the Company to recover its cost for the fire flow improvement project until a rate case, the lives and property of the ratepayers are at risk. The Company has indicated that it would wait to commence construction of the fire flow improvement project, partly because of the expense of the project.⁹⁰

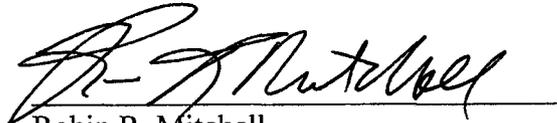
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⁸⁵ *Id.* at 994:3-5.
⁸⁶ *Id.* at 994:18-23.
⁸⁷ *Id.* at 513: 21-514:13.
⁸⁸ *Id.* at 678:1-5.
⁸⁹ *Id.* at 630-634
⁹⁰(Broderick Direct Test A-3 at 8)

1 **III. CONCLUSION**

2 Staff would urge adoption of its recommendations concerning rate base and revenue.
3 Adequate fire flow is a matter of public health and safety and has been recognized as such by this
4 Commission.⁹¹ Staff believes that the FCRM is a preferable method to pay for the fire flow
5 improvement project, to avoid the problems that have surfaced in Paradise Valley case and to protect
6 the health and safety of the customers in the Sun City Water District.

7 RESPECTFULLY submitted this 13th day of February, 2008.

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9 Robin R. Mitchell
10 Attorney, Legal Division
11 1200 West Washington Street
12 Phoenix, Arizona 85007
Telephone: (602) 542-3402

13 Original and thirteen (13) copies
14 of the foregoing were filed this
13th day of February, 2008 with:

15 Docket Control
16 Arizona Corporation Commission
17 1200 West Washington Street
Phoenix, Arizona 85007

18 Copy of the foregoing mailed this
13th day of February, 2008 to:

19 Paul M. Li, Esq.
20 Arizona-American Water Company
21 19820 North Seventh Street, Suite 201
Phoenix, Arizona 85024

22 Craig A. Marks, Esq.
23 Craig A. Marks, PLC
3420 East Shea Blvd., Suite 200
Phoenix, Arizona 85028

24 Scott Wakefield, Chief Counsel
25 Residential Utility Consumer Office
1110 W. Washington Street, Suite 220
26 Phoenix, Arizona 85007

27
28

⁹¹ Decision 68858 at 11, No. W-01303A-05-0405, W-01303A-05-0910 (Consolidated), (July 28, 2006).

1 Tracy Spoon
Sun City Taxpayers Association
2 12630 North 103rd Avenue, Suite 144
Sun City, Arizona 85351-3476
3

4 William P. Sullivan, Esq.
Susan D. Goodwin, Esq.
5 Larry K. Udall, Esq.
Curtis, Goodwin, Sullivan,
6 Udall & Schwab, P.L.C.
501 East Thomas Road
7 Phoenix, Arizona 85012-3205

8 Lloyce Robinson, Town Manager
Town of Youngtown
9 12030 Clubhouse Square
Youngtown, Arizona 85363
10

11 Mr. William E. Downey
11202 West Pueblo Court
Sun City, Arizona 85373
12

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