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Attorneys for the Resorts

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

MIKE GLEASON, Chairman
WILLIAM A. MUNDELL
JEFF HATCH-MILLER
KRISTIN K. MAYES
GARY PIERCE

IN THE MATTER OF THE APPLICATION
OF ARIZONA-AMERICAN WATER
COMPANY, INC., AN ARIZONA
CORPORATION, FOR A DETERMINATION
OF THE CURRENT FAIR VALUE OF ITS
UTILITY PLANT AND PROPERTY AND
FOR INCREASES IN ITS RATES AND
CHARGES BASED THEREON FOR
UTILITY SERVICE BY ITS PARADISE
VALLEY WATER DISTRICT.

Docket Nos.

W-01303A-05-0405
W-01303A-05-0910

NOTICE OF FILING DIRECT TESTIMONY

IN THE MATTER OF THE APPLICATION
OF ARIZONA-AMERICAN WATER
COMPANY, INC., AN ARIZONA
CORPORATION, FOR THE APPROVAL OF
AN AGREEMENT WITH THE PARADISE
VALLEY COUNTRY CLUB.

The Camelback Inn, Sanctuary on Camelback Mountain, and the Renaissance Scottsdale Resort (the "Resorts"), through its undersigned counsel, hereby provides notice that it has this day filed the written direct testimonies of John S. Thornton and Ralph Scatena in connection with the above-captioned matter.

Snell & Wilmer

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DATED this 28th day of March, 2008.

SNELL & WILMER L.L.P.

By 

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ORIGINAL and 15 copies of the foregoing
filed this 28th day of March, 2008, with

Docket Control
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COPIES of the foregoing hand-delivered
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1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2
3 COMMISSIONERS

4 Mike Gleason, Chairman
5 William A. Mundell
6 Jeff Hatch-Miller
7 Kristin K. Mayes
8 Gary Pierce

9 IN THE MATTER OF THE APPLICATION
10 OF ARIZONA-AMERICAN WATER
11 COMPANY, AN ARIZONA
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14 FAIR VALUE OF ITS UTILITY PLANT
15 AND PROPERTY AND FOR INCREASES
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17 THEREON FOR UTILITY SERVICE BY ITS
18 PARADISE VALLEY WATER DISTRICT.

DOCKET NO. W-01303A-05-0405

19 IN THE MATTER OF THE APPLICATION
20 OF ARIZONA-AMERICAN WATER
21 COMPANY FOR APPROVAL OF AN
22 AGREEMENT WITH THE PARADISE
23 VALLEY COUNTRY CLUB.

DOCKET NO. W-01303A-05-0910

24 Direct Testimony of

25 **Ralph Scatena**
26 **On Behalf of the Camelback Inn,**
Sanctuary on Camelback Mountain and the
Renaissance Scottsdale Resort (the "Resorts")

March 28, 2008

Direct Testimony of Ralph Scatena, the "Resort"
Docket Nos. W-01303A-05-0405; W-01303A-05-0910

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I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS

A. My name is Ralph Scatena. My business address is Camelback Inn, a J.W. Marriott Resort & Spa, located at 5402 E. Lincoln Drive, Scottsdale, Arizona, 85253.

Q. WHAT IS YOUR POSITION WITH THE CAMELBACK INN

A. I am the General Manager.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. I am testifying on behalf of the Camelback Inn, Sanctuary on Camelback Mountain (“Sanctuary”) and the Renaissance Scottsdale Resort (“Renaissance”) (collectively the “Resorts”). My testimony will support the rate design agreement (“Settlement Agreement”) entered into on January 15, 2008 between the Town of Paradise Valley (“Town”), representatives of various groups of Town residents (including some of the larger homeowners’ associations) and the Resorts within the Town affected by Decision No. 68858. The Settlement Agreement, which included a consensus rate design that would act as an interim solution pending the next rate case, results in immediate and needed rate relief for all effected ratepayers, including the Resorts. I will also testify that although Arizona American Water Company (“AAWC”) did not sign the Settlement Agreement, AAWC endorses the Settlement Agreement.

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///

1 II. SUMMARY OF TESTIMONY

2 Q. PLEASE SUMMARIZE YOUR TESTIMONY.

3 A. My testimony will specifically focus on why the High Usage Surcharge (“HUS”)
4 arbitrarily penalizes and unfairly impacts the Resorts. Specifically, by setting the
5 second tier at 400,000 gallons, this “conservation surcharge” for ostensibly high
6 usage does not take into consideration the unique water use characteristics of a
7 large resort and it applies standards that may be more appropriate for a
8 conventional commercial customer. As a result, the implementation of the HUS
9 does not achieve the intended conservation goals, but unfairly penalizes the Resorts
10 for water use despite the Resorts’ exemplary efforts to conserve water. As
11 described below, based upon the Resorts efficiency investments and practices, the
12 Resorts are at the forefront of water conservation.

13
14 In addition, Resort witness John Thornton will discuss the deleterious financial
15 impact to the Resorts resulting from the HUS and the Public Safety Surcharge
16 (“PSS”) implemented by AAWC under Decision No. 68858 and the subsequent
17 rate shock that resulted. As discussed by Mr. Thornton, Decision No. 68858
18 resulted in unintended and inequitable increases to the Resorts.

19 III. EFFORTS BY THE RESORTS TO CONSERVE AND PRESERVE WATER.

20 Q. **WHY DO YOU BELIEVE THAT THE CURRENT HUS DOES NOT**
21 **PROMOTE WATER CONSERVATION FOR THE RESORTS?**

22 A. It is my understanding that the purpose of a conservation surcharge is to promote
23 prudent and responsible water usage. To do this, the Commission implements a
24 surcharge, on a per thousand gallon basis, for those gallons used that the
25 Commission believes exceed a threshold amount that the Commission determines
26 to be prudent usage. Customers in this category are assessed a surcharge for all

1 gallons used that exceed this threshold amount in an effort to persuade those
2 customers to curtail their usage.

3 In this case, the HUS threshold for commercial consumption was set at 400,000
4 gallons per month. The Sanctuary, the Camelback Inn and the Renaissance use
5 approximately 3,700,000, 5,700,000 and 3,256,250 gallons on average per month,
6 respectively. Based upon the Resorts unique characteristics, they have certain
7 minimum water needs that far exceed 400,000 gallons per month. For example,
8 The Camelback Inn can host approximately 300 families a night. In contrast, the
9 residential conservation threshold was set at 80,000 gallons per month. I don't
10 believe anyone in this case would argue that 5 residential properties equal one
11 resort ($80,000 \times 5 = 400,000$). To provide some additional perspective, the
12 Camelback Inn covers 118 acres, while a typical residential home in Paradise
13 Valley covers one acre. At a minimum, tier breaks should take into consideration
14 the unique water needs of the Resorts including their relative acreage, number of
15 rooms and amenities. An arbitrary tier breakpoint serves no conservation purpose
16 and it arbitrarily penalizes the Resorts despite their efforts made towards
17 conservation as discussed below.

18 **Q. PLEASE DESCRIBE THE RESORTS EFFORTS DURING THE PAST**
19 **SEVERAL YEARS RELATED TO WATER CONSERVATION.**

20 A. In meetings with the other General Managers of the Resorts, we have identified
21 several of the conservation efforts already made by the Resorts including the
22 following: replacing high water use plants and grass with xeriscape landscaping;
23 upgrading and improving irrigation management systems and infrastructure;
24 minimizing water use through efficient delivery systems and prudent water
25 conservation policies; and seasonal and climactic adjustment.
26

1 **Q. WHAT IS XERISCAPE LANDSCAPING?**

2 A. Xeriscape landscaping is landscaping that minimizes supplemental irrigation. The
3 Arizona Department of Water Resources (“ADWR”) has identified seven principles
4 of xeriscaping that we attempt to incorporate into our property’s landscaping. A
5 copy of ADWR’s principles is attached as Exhibit RS-1.

6 **Q. PLEASE DESCRIBE THE CAMELBACK INN’S EFFORTS TO
7 REPLACE HIGH WATER USE PLANTS AND GRASS WITH
8 XERISCAPE LANDSCAPING.**

9 A. The Camelback Inn extensively employs xeriscape planting around its 118 acre
10 resort property to avoid watering in those areas. Of The Camelback Inn’s 118 acres,
11 16% has no landscaping and only 4% of the acreage (or less than 5 acres) is in
12 grass. During remodeling at The Camelback Inn in 2003 and 2007, grassy areas
13 were converted into xeriscape landscaping wherever possible. The end result was
14 that over 2 acres of grass was converted into xeriscape landscaping, a reduction in
15 turf of approximately 29%.

16
17 **Q. PLEASE DESCRIBE THE CAMELBACK INN’S EFFORTS TO
18 UPGRADE AND IMPROVE ITS IRRIGATION MANAGEMENT
19 SYSTEMS AND INFRASTRUCTURE.**

20 A. The Camelback Inn has invested in a Rain Bird Stratus Golf Central Control
21 System, which is a state-of-the-art electronic irrigation system that is the most
22 advanced irrigation system in the world. The Camelback Inn’s system has
23 distributed valves that water different vegetation differently. For example, older
24 trees are irrigated once every two weeks while other plants are watered according
25 to their minimum needs. This gives The Camelback Inn the ability to regulate
26 water flow to all of our plant life to prevent over watering in areas that don’t

1 require water on a regular basis. Without this system all vegetation would receive
2 the same amount of water, resulting in excess water use. In addition, the landscape
3 manager can control the entire irrigation system remotely by laptop from anywhere
4 in the world so that if any leaks are detected at the resort, the personnel can contact
5 her and she can immediately shut off valves to conserve water. Our landscape
6 manager also has the ability to shut down the entire system via laptop when rain is
7 detected in the area. We are currently looking into a monitoring system that would
8 allow the system to shut itself down if it detects rain. In addition, throughout the
9 resort, The Camelback Inn use drip irrigation wherever possible.

10 **Q. PLEASE DESCRIBE THE CAMELBACK INN'S EFFORTS TO**
11 **MINIMIZE WATER USE THROUGH THE INSTALLATION OF HIGH-**
12 **EFFICIENCY WATER DELIVERY SYSTEMS.**

13 A. The Camelback Inn has already upgraded its water delivery systems to feature
14 100% drip irrigation to plants, 100% bubblers to flowers, and sprinklers minimized
15 to the increasingly limited turf areas. These systems minimize, to the extent
16 possible with current technology, water delivery to the various plant species (by
17 age) on the property. We only use hoses in rare emergencies.

18 The Camelback Inn has also installed recirculation pumps in all rooms at the resort.
19 These pumps provide hot water at first opening of the tap without having to waste
20 water down the drain waiting for it to get hot. Measurements taken at The
21 Camelback Inn indicate a savings of approximately 1 1/2 gallons of water every
22 time a faucet is turned on for hot water.

23 In addition, back in 1996, The Camelback Inn was the first resort in the industry to
24 remove the standard 4 gallon flush toilets and replace them with power flush toilets
25 that use compressed air and 1.6 gallons of water per flush saving 3.4 gallons per
26

1 flush. The Camelback Inn also installed new shower heads that regulate the water
2 flow while enabling guests to enjoy an adequate high pressure shower. A test run
3 shows that these new heads save approximately 20 to 25 gallons of water per 10
4 minutes of shower time as compared to the old-style shower heads. The
5 Camelback Inn also installed Perlator economy flow aerators that regulate the flow
6 of sink water in guest rooms to 1.5 GPM and still produce an inviting flow for
7 guest needs. All public space restrooms are equipped with Toto or American
8 Standard sensor faucets, urinals and toilets to avoid unnecessary water waste. The
9 Camelback Inn also replaced the main kitchen Hobart dish washer with a
10 Champion dish washer, which saves approximately 55% in water and energy usage
11 and is ENERGY STAR¹ compliant.

12 **Q. DOES THE CAMELBACK INN ADJUST ITS WATERING PRACTICES**
13 **BASED UPON CLIMATE CHANGES?**

14 A. Yes. The Camelback Inn's landscape manager tailors its irrigation use specifically
15 for seasonality and daily conditions. For example, cacti are not watered at all from
16 November to May and irrigation is shut off remotely with a call to our landscape
17 manager if rain is present.

18 **Q. HAS THE CAMELBACK INN IMPLEMENTED ANY OTHER WATER**
19 **CONSERVATION POLICIES?**

20 A. Yes. At The Camelback Inn, the Chief Engineer conducts a weekly walk around to
21 look for any leaks or dripping faucets that need repair to avoid wasting water. In

22 ¹ ENERGY STAR employs strategies that in the aggregate use a minimum of 20 percent less
23 potable water than the indoor water use baseline calculated for a building, after meeting the
24 Energy Policy Act of 1992 fixture performance requirements. In addition, ENERGY STAR
25 promotes the use of efficient landscaping and irrigation strategies, including water reuse and
26 recycling, to reduce outdoor potable water consumption by a minimum of 50% over that
consumed by conventional means as well as employs design and construction strategies that
reduce storm water runoff and polluted site water runoff.

1 addition, The Camelback Inn has a stringent weigh-in process for laundry to ensure
2 that the proper pounds are put into washers to maximize the useful life of the
3 equipment and maximize the efficiency of water used per cycle. The Camelback
4 Inn has also implemented a linen recycle program in which bed sheets are changed
5 out every 3 days of the same guest's stay as opposed to changing the sheets
6 everyday while the guest occupies the room. This is a significant water savings for
7 laundry. In addition, The Camelback Inn has implemented a water treatment
8 program that enables it to cut back on cooling tower water use, which saves
9 approximately 1,500 gallons of water per month.

10 **Q. IS THERE ANY OTHER SIGNIFICANT TECHNOLOGY THAT THE**
11 **CAMELBACK INN COULD EMPLOY TO REDUCE WATER USE AT**
12 **THE RESORT?**

13 A. Although we utilize the latest state-of-the-art technologies for reducing water
14 consumption, The Camelback Inn is always looking at new technologies where
15 water conservation is concerned. We are currently looking at upgrading our
16 irrigation system with a monitoring system so the system will shut itself down
17 automatically if rain is present instead of having to call the landscape manager to
18 turn it off remotely.

19 **Q. WHAT TYPE OF INCREASE IN WATER RATES DID THE**
20 **CAMELBACK INN EXPERIENCE AS A RESULT OF DECISION NO.**
21 **68858?**

22 A. Taking into account the basic increases as well as the two surcharges, The
23 Camelback Inn's water rates have gone up approximately 220%, or an additional
24 \$220,620 per year. As a result, this increase puts us at a competitive disadvantage
25 to those resorts served by municipal providers or other private water companies
26 that have not experienced this type of increase.

1 **Q. ARE YOU FAMILIAR WITH THE EFFORTS OF THE SANCTUARY**
2 **AND THE RENAISSANCE WITH REGARD TO WATER**
3 **CONSERVATION?**

4 A. I have had some discussions with the General Managers of these two resorts and I
5 can offer a brief overview. It is my understanding that The Sanctuary invested
6 approximately \$500,000 between 2005 and 2006 to upgrade its water
7 infrastructure, including more efficient irrigation systems, despite the fact that it is
8 almost entirely xeriscaped. In addition, The Sanctuary has approximately 0.58%,
9 or less than 1%, of its square footage in grass. Thus, there is essentially nothing
10 more that The Sanctuary can do to reduce turfed areas.

11 The Renaissance has a new landscape maintenance service that is specifically
12 charged with reducing water use through conservation, improved irrigation
13 maintenance, drip irrigation, and elimination of overspray. The property also has
14 extensive xeriscape and low-water-use vegetation. In addition, much of the
15 property's guest rooms are shut down during the off-season so that no water or
16 energy is used to service those portions of the property. Many pools and spas are
17 not heated during the off season, thereby reducing evaporation. The Renaissance
18 also invested in Eco-Lab's Formula-1 laundry control system that reduces rinse and
19 flush cycles, lowering water use by 11%. The Renaissance has implemented
20 conservation programs such as encouraging guests to reuse linens and towels
21 during their stay. All guest rooms at The Renaissance have been fitted with new
22 low-flow shower heads that reduce use of hot water by 10%.

23 Finally, both The Camelback Inn and The Renaissance conserve water pursuant to
24 Marriott's guide for best practices that mandates a specific energy conservation
25 program, including conservation of water.
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Q. WHAT DO YOU CONCLUDE REGARDING THE RESORTS' WATER EFFICIENCY INVESTMENTS AND PRACTICES?

A. These efficiency investments and practices all translate into being better stewards of our precious water resource as well as being wise business decisions. The Resorts are a class of customer at the forefront of prudent water usage.

Q. WHY IS THE APPROVAL OF THE SETTLEMENT AGREEMENT NECESSARY AT THIS TIME?

A. At status quo, the Resorts will automatically be assessed a significant HUS based upon the arbitrary second tier amount of 400,000 gallons, which does not seem to be based upon any industry data. Based upon the Resorts' water usage patterns, the HUS will not promote any additional significant conservation and is therefore a purely punitive charge. The Settlement Agreement, although does not modify the tier breakpoints, would maintain the beneficial goals of providing needed fire flow improvements and encouraging water conservation while fairly distributing the costs of such improvements among current and future customers of the Paradise Valley Water District.

Q. WHY SHOULD THE COMMISSION APPROVE AN INTERIM SOLUTION WHEN AAWC INTENDS TO FILE ANOTHER RATE CASE IN THE SPRING OF THIS YEAR?

A. I have been advised that the process for litigating a rate case can be in excess of one year. The Resorts need rate relief now. In addition, if an interim solution is approved, it would be most beneficial for the Resorts if the new rate design was implemented prior to the high water usage summer months.

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IV. CONCLUSION

Q. WOULD PLEASE SUMMARIZE YOUR DIRECT TESTIMONY?

A. Yes. Approval of the Settlement Agreement will mitigate the deleterious financial impact to the Resorts resulting from the HUS and PSS implemented by AAWC under Decision No. 68858. I have shown why the HUS penalizes the Resorts for water use despite the Resorts best efforts to conserve water thereby failing to achieve its intended conservation goals. The Resorts are at the forefront of prudent water usage based upon their strident conservation efforts, including replacing high water use plants and grass with xeriscape landscaping, upgrading and improving irrigation management systems and infrastructure, minimizing water use through efficient delivery systems and prudent water conservation policies, and implementation of seasonal and climactic adjustment, they are a class of customer at the forefront of prudent water usage.

Q. DOES THAT CONCLUDE YOUR PRE-FILED DIRECT TESTIMONY?

Yes it does.

Exhibit RS-1



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Seven Principles of Xeriscape

1. Thoughtful landscape planning & design - Begin with a plan, whether it's a new or remodeled landscape. A good design will avoid wasting your water, time, and money. Think long-term, and be realistic about the space requirements of mature plants. This will help you avoid maintenance headaches later on.

2. Select low-water-use plants - Many books exist on this subject, and hundreds of native plants, as well as plants from other low-rainfall regions, are adapted to grow in the Sonoran Desert. Keep Principle Number 1 foremost in mind before buying plants for your Xeriscape. A good design is invaluable in selecting and combining water-efficient plants that will add beauty and utility to your outdoor areas. [Free drought-tolerant, low-water-use plant list for your area.](#)

3. Appropriate turf (lawn) areas - Lawns use a lot of water. For that reason, include them when only a lawn will do, as in a children's play area. Keep the lawn area small and simple in shape, and border it with low-water-use plants. Select adapted grasses such as hybrid Bermudas. Avoid lawn for use only as a ground cover -- use other water-efficient ground covers instead. Inorganic mulches such as decomposed granite use zero water and can be effective as well.

4. Efficient irrigation - Drip-irrigation systems are efficient at applying water to plants in the right amounts at the root zone. Use a timer and adjust schedules as plant needs change with age and from season to season. Check systems regularly to be sure they are working properly. If you water with a hose, learn the water requirements of all your plants -- they can vary quite a bit. Check soil for moisture to see if plants actually *need* water. Avoid sprinkling; water deeply and infrequently after new plants are established.

5. Improve the soil - Adding organic matter to the soil before planting increases its water- and nutrient-holding capacity, which improves plant growth and efficient use of water. Annuals, perennials, and vegetables - plants that are planted in close proximity to one another -- are prime candidates. Low-water-use native trees, shrubs, and ground covers usually do just fine in unimproved existing soil, but they often appreciate organic mulches. (See Principle Number 6.)

6. Use mulches - Mulch is a layer of just about any material -- organic or inorganic -- that covers the soil over the root area of plants. Mulch reduces moisture loss through evaporation, insulates plant roots from heat and cold extremes, and cuts down on weed populations that steal

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water and nutrients from your plants. Add a few inches of organic mulch each spring -- it will decompose to improve the soil.

7. Appropriate maintenance - Healthy plants grow and look better, as you would naturally expect, and use water more efficiently. Prune properly at the right time of year. Do not prune heavily at any one time, particularly during summer. Keep a close and regular eye out for pests and diseases. You want to spot them early when controls are easier and more effective. Keep up with weeds. Don't over-fertilize, which can result in excessive plant growth that requires even more pruning.

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Phoenix, Arizona 85012

Effective November 28th, 2005, our location
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1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

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25 **John S. Thornton**
26 **On Behalf of the Camelback Inn,
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1 **I. Witness Identification**

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

3 A. My name is John S. Thornton. I am an independent consultant in utility finance
4 and economics.
5

6
7 **Q. PLEASE DESCRIBE YOUR WORK EXPERIENCE AND EDUCATIONAL**
8 **BACKGROUND.**

9 A. I hold a Master of Science degree from the University of London, having completed the
10 Master's program (economics with specialty in corporate finance) at the London School of
11 Economics and Political Science ("LSE"). I also hold a Graduate Diploma from the LSE. I have
12 participated as a cost of capital expert in numerous electric utility, local gas distribution, and
13 telephone cases in the states of Oregon, Washington, California, Nevada, Oklahoma, and
14 Arizona, and I participated in gas pipeline cases before the Federal Energy Regulatory
15 Commission. I worked at the Public Utility Commission of Oregon for thirteen years and left as a
16 Senior Economist and its chief rate-of-return and finance witness. Subsequently, I became Chief
17 of the Financial and Regulatory Analysis Section of the Arizona Corporation Commission's
18 ("Commission") Utility Division.
19

20
21 I now consult independently for investors and consumers on utility matters. My
22 background is described further in my Witness Qualifications Statement found on Exhibit JST-1.
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II. Purpose of Testimony

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to support the Rate Design Agreement (“Settlement Agreement”) filed by the Town of Paradise Valley on January 16, 2008. I support the Settlement Agreement by discussing the deleterious rate impact of Arizona American Water Company’s (“AAWC”) Paradise Valley Water District’s (“PVWD”) existing rates on three of its resort customers: The Sanctuary on Camelback Mountain, The Camelback Inn, and the Scottsdale Renaissance (the “Resorts”). I also discuss how the Settlement Agreement will benefit residential customers.

PVWD’s current rates were approved in Commission Decision No. 68858 (July 28, 2006). I discuss the unintended rate shock effects on the Resorts due to the \$1.00 Public Safety Surcharge (“PSS”) and the \$2.15 High Usage Surcharge (“HUS”) being assessed to the Resorts for water usage above 400,000 gallons per month. These two surcharges together exceed the base cost of water and they have contributed to the Resorts facing excessive bill increases up to 220%. The HUS arbitrarily penalizes and unfairly impacts the Resorts because it does not take into consideration the unique characteristics and water needs of a resort. Rather, the HUS might be more appropriate for a conventional commercial customer. As a result, the HUS does not achieve its intended conservation goals but arbitrarily penalizes the Resorts for unavoidable water use despite the Resorts’ demonstrated best efforts to conserve water. The Resorts’ witness Ralph Scatena details how the

1 Resorts are at the forefront of prudent water usage based upon their efficiency
2 investments and water use practice in his direct pre-filed testimony.

3 **Q. ARE YOU SPONSORING ANY EXHIBITS?**

4 A. Yes, I sponsor Exhibit JST-1 attached to my testimony.
5

6 **III. Recommendations**

7 **Q. WHAT DO YOU RECOMMEND IN THIS CASE?**

8 A. I recommend that the Commission amend Decision No. 68858 by adopting the Settlement
9 Agreement. The Settlement Agreement resulted from months of work and incorporates the
10 viewpoints and concerns of numerous stakeholders expressed throughout the negotiation process.
11 The Settlement Agreement generally provides that the HUS be reduced from \$2.15 to \$1.00 per
12 thousand gallons and that the PSS be converted to a revenue-requirement-based surcharge from a
13 contributions-in-aid-of-construction ("CIAC")-based surcharge. The PSS would initially be
14 eliminated and AAWC would file surcharge requests similar to its arsenic cost recovery
15 mechanism filings ("ACRM") as new fire flow improvement projects became used and useful.
16 The new PSS would apply to the same commodity portion of rates as it does currently.
17
18

19 **IV. Decision No. 68858 and its Rate Effect on the Resorts**

20 **Q. WHAT EFFECT HAS DECISION NO. 68858 HAD ON THE RESORTS'**
21 **WATER BILLS?**

22 A. Decision No. 68858 increased annual forecasted water bills to the Resorts in
23 approximately the following degrees:
24

25

Effect of New Rates on the Resorts		
Resort	\$ Annual Increase	% Increase

26

The Sanctuary on Camelback Mountain	\$129,444	221%
The Camelback Inn	\$220,620	220%
The Scottsdale Renaissance	\$115,059	192%
Includes new base rates, HBS, PSS and ACRM Phase 1 only		

Q. WHAT ARE THE PRIMARY CAUSES OF THE RATE INCREASE TO THE RESORTS FROM DECISION NO. 68858?

A. The primary causes of the rate increase are the \$2.15 HUS and the \$1.00 PSS (compared to the approximate \$1.56 commercial Tier 2 cost of water). Moreover, the HUS and PSS apply to the second of only two commercial tiers, and that second commercial tier begins at an unusually low breakpoint for a resort's water needs (as opposed to a more traditional commercial establishment). The second commercial tier for PVWD rates begins at only 400,000 gallons but a resort can meter millions of gallons a month to serve thousands of guest nights in a month. The chart below illustrates the problem using the Camelback Inn's main six-inch meter:

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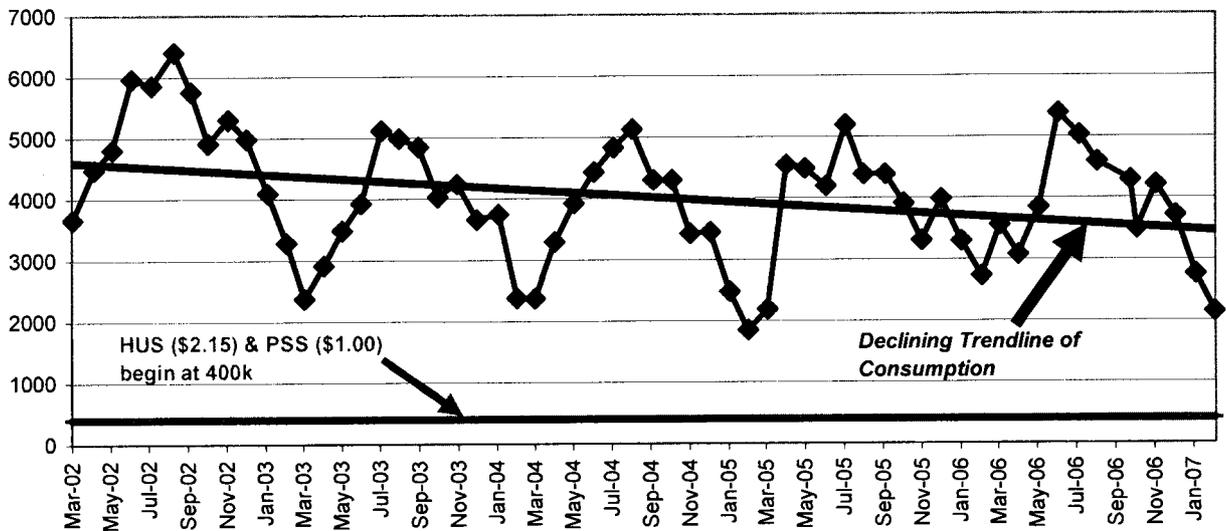
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Camelback Inn's Main 6" Meter No. 07009533A
 Declining Water Usage from Conservation Measures
 Monthly Water Usage (in 000's) March 2002 to February 2007



As you can see, the Camelback Inn's main six-inch meter has metered about 4,000,000 gallons per month on average over the past five years and its consumption has had a declining trendline. The problem is that the HUS and PSS begin at only 400,000 gallons per meter per month. Effectively, the HUS applies to ninety percent of the Camelback Inn's consumption through its six-inch meter, on average, rather than any particularly high block of consumption. Resort witness Mr. Scatena will describe in detail the Resorts' concerted efforts to reduce and manage water use that have resulted in the resort's declining trendline of consumption, which began well before the imposition of the HUS and PSS in Decision No. 68858. The Resorts have demonstrably been good stewards of their water usage as they have responded to corporate cost reduction mandates. The Resorts face commercial pressures to constantly find cost savings where possible, and utilities expenses are an obvious target of cost savings efforts. Unfortunately, the economic

1 benefits of the Resorts' conservation efforts have largely been eliminated by the HUS and PSS.
2 The Sanctuary , the Camelback Inn and the Renaissance use approximately 3,300,000, 5,700,000
3 and 3,500,000 gallons on average per month, respectively. The Resorts have certain minimum
4 water requirements that far exceed 400,000 gallons per month. Tier breaks should consider the
5 Resorts' basic health and safety needs and could consider other rate class minimums including the
6 residential class. Establishing an arbitrary "one-size-fits-all" tier of 400,000 gallons without
7 taking into consideration the unique water needs of the Resorts, including their relative sizes
8 compared to other customers serves no well-designed conservation purpose and arbitrarily
9 penalizes the Resorts despite their best efforts made towards conservation. The Settlement
10 Agreement mitigates this tier break problem.
11

12 **Q. WOULD YOU CONSIDER THESE RATE INCREASES "RATE SHOCK?"**

13
14 A. Yes, I would consider these rate increases rate shock. Rate shock is a term for a
15 somewhat subjective description of a rate increase that is large relative to current rates or larger
16 than anticipated in customers' minds. Therefore, rate shock exists in the minds of customers
17 rather than in a mathematical calculation per se. I can say that the Resorts are suffering rate
18 shock as a result of Decision No. 68858 given the increases approximated above and their
19 expectations of the rate increase based upon the notice provided by AAWC.
20

21
22 **Q. COULD THE RESORTS' GENERAL MANAGERS HAVE ANTICIPATED**
23 **THE RATE EFFECTS OF DECISION NUMBER 68858?**

24 A. No, they could not have reasonably anticipated the effect of Decision No. 68858 because
25 the notices that were provided for the underlying rate case did not clearly alert them to the
26

1 potential effects of the HUS or PSS. The original notice indicated that the rate increase sought
2 would result in a 9% increase to the average residential customer. The PSS, ACRM or HUS
3 dollar figures were not specifically mentioned. A reasonable business person reading the notice
4 would have anticipated a general rate increase of approximately 9 percent. A letter by Brian
5 Biesemeyer, P.E., General Manager of the Company, sent to customers on September 6, 2005 and
6 docketed on September 16, 2005, alerted readers to a 5.4% base rate increase. The letter of notice
7 failed to mention the effective \$2.15 HUS that far exceeds the \$1.57 Commercial Tier 2 base rate
8 of water requested. The notice omissions, however unintended, were economically prejudicial to
9 the Resorts' interests as the general managers would have surely intervened had they been
10 informed of the serious economic impact these surcharges would have had on their businesses.
11 The Resorts cannot simply absorb such increases without suffering a competitive disadvantage
12 vis-a-vis those resorts in the area that are not served by AAWC and who are not subjected to
13 these significant surcharges. Water utility rates affect business competitiveness and the local
14 economy. The Settlement Agreement mitigates the notice's omissions.
15
16

17 **Q. ON WHAT ORDER OF MAGNITUDE DOES A RESORT'S HIGH BLOCK**
18 **(TIER 2) BREAKPOINT COMPARE TO THE RESIDENTIAL HIGH BLOCK**
19 **(TIER 3) BREAKPOINT?**

20 A. The top residential Tier 3 begins at 80,000 gallons per month. The top commercial Tier 2
21 rate begins at consumption above 400,000 gallons per month, or only the equivalent of 5
22 residences. However, the Resorts can host hundreds of families a night and they must serve
23 hundreds of employees. The Resorts cannot reasonably attain water usage volumes below the top
24
25
26

1 Tier 2. Therefore, the commercial Tier 2 appears arbitrary for a resort and it serves no
2 conservation purpose.

3 **Q. HOW MANY CUSTOMERS DO THE THREE RESORTS SERVE**
4 **COMPARED TO THE OCCUPANTS OF A RESIDENCE?**

5 AAWC witness Mr. Paul G. Townsley testified in this case that the average household size in
6 Paradise Valley was 2.71 persons in 2000 (see Direct Testimony of Paul G. Townsley, page 14).

7 The table below depicts the average monthly sizes of the three resorts:
8

9

Sizes of the Three PVWD Resorts			
Resort	Rooms	Hotel Guest Nights Per Month	Total People Per Month*
The Sanctuary on Camelback Mountain	105	4,000	17,823
The Camelback Inn	453	23,870	50,870
The Scottsdale Renaissance	171	5,727	8,953
Total	729	33,597	77,646

10

11

12

13 * Includes hotel guests, catering, spas, and restaurants.

14

15 Therefore, the Resorts' health and safety needs would be expected to far exceed five times a
16 residence's needs given that resorts provide services for so many more customers and employees
17 than could be expected of an average residence's occupants.

18 **Q. HOW DO THESE MAGNITUDES SUPPORT THE COMMISSION'S**
19 **ADOPTING THE SETTLEMENT AGREEMENT?**

20

21 A. These magnitudes highlight the fact that the HUS and PSS affect the Resorts very
22 dramatically (because of the low commercial Tier 2 breakpoint compared to their health and
23 safety needs and compared to the residential breakpoints). Supporting the Settlement Agreement
24 would maintain the beneficial goals of providing needed fire flow improvements and encouraging
25 water conservation while fairly distributing the costs of such improvements among current and
26

1 future customers of the PVWD. It would also provide needed rate relief and restore a certain
2 amount of rate fairness to the Resorts by reducing the HUS to \$1.00 and converting the PSS to a
3 traditional revenue-requirements surcharge.
4

5
6 **V. Competitive Issues**

7 **Q. CAN YOU PROVIDE AN EXAMPLE OF THE COMPETITIVENESS**
8 **ISSUE BETWEEN THE RESORTS AND THEIR COMPETITORS UNDER CITY**
9 **OF SCOTTSDALE OR CITY OF PHOENIX RATES?**

10 A. Yes, I can. A resort would pay approximately the following for 4,000,000 gallons through
11 a six-inch meter under the three rate schedules:

12

Approximate Monthly Water Costs for 4,000,000 gallons through a 6" Meter Fixed Monthly and Rate Charges Only	
Water Provider	Monthly Cost
Resorts	\$20,085
The City of Phoenix	\$13,876
The City of Scottsdale	\$12,274

13
14
15
16

17
18 City of Scottsdale water rates include a \$320.76 fixed monthly charge for a six-inch meter and
19 three tiers of rates, the highest tier beginning at 6,250,000 gallons per month. City of Phoenix
20 water rates include a \$44.38 (inside city) fixed monthly charge for a six-inch meter (including
21 gallons of water depending on the month) and seasonal but non-tiered rates. Businesses within
22 AAWC's PVWD should remain competitive with their Scottsdale and Phoenix rivals to the extent
23 possible through just and reasonable rates.
24
25
26

1 **Q. DO THE HUS AND PSS AGGRAVATE OTHER BUSINESS**
2 **COMPETITIVENESS ISSUES THAT WOULD BE MITIGATED BY THE**
3 **SETTLEMENT AGREEMENT?**

4 A. Yes, the HUS and PSS are designed to effectively pre-fund or finance PVWD's fire flow
5 infrastructure upgrades through CIAC over the next four years or so. Unfortunately, in about four
6 years, three new resort properties will come online in the PVWD: Mountain Shadows,
7 Montelucia, and the Ritz Carlton. Therefore, the Resorts will have completely funded all
8 infrastructure upgrades that could benefit their three new competitors who will not have to pay for
9 the upgrades. This inequity is a dramatic example of the "intergenerational transfer problem" that
10 we want to avoid in setting regulated rates. Those who enjoy the benefit (of fire flow upgrades
11 for example) in any given year should pay the cost. Since the benefit of the new fire flow
12 upgrades will be enjoyed over many decades, the cost should be borne over many decades. The
13 Settlement Agreement mitigates the intergenerational transfer problem caused by the existing
14 HUS and PSS. The Settlement Agreement also supports the beneficial goals of providing needed
15 fire flow improvements and encouraging water conservation all while more fairly distributing the
16 costs of such improvements among current and future customers.

19 **Q. WILL RESIDENTIAL CUSTOMERS BENEFIT FROM THE**
20 **COMMISSION'S ADOPTING THE SETTLEMENT AGREEMENT?**

21 A. Yes, adopting the Settlement Agreement will benefit residential customers because no rate
22 will be higher than it is currently but residential tiers two and three will be lower. Moreover, the
23 Settlement Agreement helps to mitigate the intergenerational problem caused by the current HUS
24 and PSS because future customers who get the benefit of the new fire flow infrastructure
25
26

1 upgrades will pay for their cost. The current HUS and PSS force current residential customers to
2 finance the upgrades through about four years of CIAC though the upgrades will be enjoyed by
3 about four decades of residential customers.
4

5
6 **VI. Conclusion**

7 **Q. PLEASE SUMMARIZE YOUR CONCLUSIONS AND**
8 **RECOMMENDATION.**

9 A. The Commission should adopt the Settlement Agreement's principles and amend Decision
10 No. 68858 as it will result in immediate rate relief for all customers, both commercial and
11 residential, and such amendment will result in more just and reasonable rates for all PVWD
12 customers.

13 **Q. DOES THIS CONCLUDE YOUR PRE-FILED DIRECT TESTIMONY?**

14 A. Yes, it does.
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Witness Qualifications Statement

NAME: JOHN S. THORNTON, JR.

ADDRESS: 7929 E Joshua Tree Lane, Scottsdale AZ 85250-7967

EDUCATION: Master of Science Degree from the University of London, having completed the graduate program in economics at The London School of Economics and Political Science (1986)

Graduate Diploma in Economics from The London School of Economics (1985)

Bachelor of Arts degree, major in economics, from Willamette University (1984)

Certified Rate of Return Analyst, member of the Society of Utility and Regulatory Financial Analysts

1998 passed level I of the CFA

1995 PaineWebber Seminar on Corporate Finance for the Utility Industry

1990 MIT/Harvard Public Disputes Resolution Program seminar

1990 National Association of Regulatory Utility Commissioners (NARUC) Advanced Regulatory Studies Program

1988 NARUC Annual Regulatory Studies Program

EXPERIENCE: **Thornton Financial Consulting - Principal, 2004 to present**

Docket No. E-01933A-07-0402 re: In the matter of the application of Tucson Electric Power Company for the establishment of just and reasonable rates and charges designed to realize a reasonable rate of return on the fair value of its operations throughout the State of Arizona. Handicapped rate case outcomes. Analysis provided to a number of Wall Street investment firms through The Gerson Lehrman Group. (2008)

Docket No. W-01303A-05-0405 re: In the matter of the application of Arizona - American Water Company Inc. for approval of a determination of the current fair value of its utility plant and property; and for increases in its rates and charges based thereon for utility service by its Paradise Valley Water District. Provided revenue requirement and rate spread/rate design analysis related to High Block Usage Surcharge and Public Safety Surcharge to resort customers and proposed alternative surcharges. Forecasted seasonal resort consumption and bills and documented conservation efforts. (2007)

Docket No. W-01445A-06-0200 et alia re: Arizona Water Company vs. Global Water Resources, Inc. Filed testimony on behalf of Arizona Water Company.

Analyzed Global Water Resources' financial structure, affiliated interest issues, and use of Infrastructure Coordination and Financing Agreements. (2007)

Docket No. 06-11022 re: application of Nevada Power Co. for authority to increase its annual revenue requirement for general rates charged to all classes of electric customers and for relief properly related thereto: Rate of return witness for intervenor MGM-Mirage. (2007)

Docket No. E-01345A-05-0816 re: In the matter of the application of Arizona Public Service Company for a hearing to determine the fair value of the utility property of the company for ratemaking purposes, to fix a just and reasonable rate of return thereon, to approve rate schedules designed to develop such return, and to amend Decision No. 67744. Provided analysis and commentary to Wall Street hedge fund clients on ACC decision process and procedures and likely outcome of the ACC vote. (2007)

Docket No. E-01933A-05-0650 re: application of Tucson Electric Power Company to amend Arizona Corporation Commission (ACC) Decision No. 62103. Provided analysis and commentary to GLG clients on ACC decision process and procedures and likely outcome of the ACC vote. (2005-2006)

Case No. 200500151 re: application of Oklahoma Gas and Electric Company for authority to increase its electric rates. Rate-of-return witness for intervenor Oklahoma Industrial Energy Consumers. (2005)

Docket No. E-01933A-04-0408 re: in the matter of the filing of general rate case information of Tucson Electric Power Co. pursuant to Decision No. 62103. Provided analysis on process & procedure, likely positions to be taken by parties, and revenue requirement analysis after impacts of potential or likely disallowances. Analysis provided to a number of Wall Street investment firms through The Gerson Lehrman Group. (2004-2005)

Docket No. E-04230A-03-0933 re: in the matter of the reorganization of UniSource Energy Corporation. Analyzed proposed acquisition of UniSource by KKR through Saguaro Acquisition Corp. Provided analysis and commentary on Arizona Corporation Commission (ACC) decision process and procedures and likely outcome of the ACC vote. Analysis provided to a number of Wall Street investment firms through The Gerson Lehrman Group. (2004)

Docket No. UM 1121 re: application of Oregon Electric Utility Co., LLC, et alia for authority to acquire Portland General Electric Co. Analyzed the proposed acquisition of Portland General Electric Co. by the Texas Pacific Group from the Enron bankruptcy estate on behalf of the Industrial Customers of Northwest Utilities. (2004)

Case Nos. AVU-E-04-01 and AVU-G-04-01 re: application of Avista Corporation for authority to increase its electric rates. Rate-of-return witness for intervenor Potlatch Corporation. (2004)

Docket Nos. 03-10001 and 03-10002 re: application of Nevada Power Co. for authority to increase its annual revenue requirement for general rates charged to all classes of electric customers and for relief properly related thereto: Rate of return witness for intervenor MGM-Mirage. (2004)

Docket Nos. 01-10001 and 01-10002 re: application of Nevada Power Co. for authority to increase its annual revenue requirement for general rates charged to all classes of electric customers and for relief properly related thereto: Rate of return witness for intervenor MGM-Mirage. (2002)

Docket No. UE 010395 re: application of Avista Corporation d/b/a Avista Utilities request for recovery of power costs through the deferral mechanism. Corporate finance witness for the Industrial Customers of Northwest Utilities. (2001)

Docket Nos. 99-4001 and 99-4005 re: Sierra Pacific Power Co. compliance filing Docket No. 99-4001 and Nevada Power Co. compliance filing Docket No. 99-4005. Rate of return witness for intervenors Mirage Resorts, Inc., Park Place Entertainment Corp., and the Mandalay Group. (2000)

Application Nos. 98-05-019, 021, & 024. Presented beta adjustment and distribution risk discount testimony on behalf of the Division of Ratepayer Advocates of the California Public Utility Commission. (1998)

Speaker—US Agency for International Development's Conference on Private Sector Participation in the Colombian Power Sector. (1991)

Chief, Financial & Regulatory Analysis Section, Utilities Division, Arizona Corporation Commission, 2001 to 2004

Testified or provided reports in the following dockets:

- W-01656A-98-0577 & WS-02334A-98-0577—Sun City Water Co. and Sun City West Utilities Co.'s request for approval of the Central Arizona Project water utilization plan. Testimony on the effect of the Groundwater Savings Project on Sun City Water Co. and Sun City West Utilities Company's revenue requirement.

- E-01345A-02-0707—Arizona Public Service Co.'s application for authority to incur \$500,000,000 of debt and to acquire a financial interest in an affiliate by lending \$500,000,000 to Pinnacle West Capital Corp. or Pinnacle West Energy

Corp. Alternatively, APS' application to guarantee \$500,000,000 of PWCC or PWEC debt. Testimony on the appropriateness of the affiliate transactions and seven conditions under which the loan could be made.

- E-01345A-02-0840—Arizona Public Service Co.'s application for authority to loan \$125,000,000 of debt to an affiliate. (Staff report regarding four conditions under which the affiliate transaction would be appropriate.)

- E-01345A-02-0403—Arizona Public Service Co.'s application for approval of adjustment mechanisms. Testimony on a power supply adjustor earnings test.

- E-01032-00-0751, G-01032A-02-0598, E-01933A-02-0914, E-1032C-02-0914, G-01032A-02-0914—Consolidated dockets of UniSource, Citizens Communications Arizona Gas Division (AGD), & Citizens Communications Arizona Electric Division (AED); general rate case for the AGD, PPFAC adjustment for AED, and sale of AGD and AED to UniSource. (Staff report section on analysis of the financing of the sale and transfer of utility assets.)

- W-01445A-02-0619—Arizona Water Company's application for rates and charges for eight systems. Testimony on implementing lifeline rates and marginal cost pricing into rate design, resulting in inverted block rates.

Senior Analyst with the Public Utility Commission of Oregon, 1988-2001

Testified or provided rate of return analyses in the following dockets:

- UE 102—PGE disaggregation/general rate case (chief rate of return witness).

- UE 94—PacifiCorp general rate case (chief rate of return witness).

- UE 93 (UM 592, UM 694)—Portland General Electric Co. excess power cost/Coyote/BPA filing.

- UE 92—Idaho Power general rate case.

- UE 88—Portland General Electric Co. general rate case (chief rate of return witness).

- UE 85/UM 529—Portland General Electric Co. Earnings test for Trojan Shutdown Cost Adjustment Account.

- UE 84—Idaho Power Co. deferred account earnings benchmark.

- UE 82/UM 445—Trojan Outage Cost Adjustment Account earnings test benchmark.

- UE79—Portland General Electric Co. general rate case (chief rate of return witness).
- UG 104/UG 105/UG 106—LDC deferred account earnings test benchmarks.
- UG88—Cascade Natural Gas Co. general rate case (chief rate of return witness).
- UG81—Northwest Natural Gas Co. general rate case (chief rate of return witness).
- UT 125—US WEST Communications, Inc general rate case (chief rate of return witness).
- UT 113—GTE Northwest general rate case (chief rate of return witness).
- UT101—United Telephone Co. of the Northwest general rate case (chief rate of return witness).
- UT85—US WEST general rate case (capital structure and debt cost witness).
- RP95-409—Northwest Pipeline general rate case (FERC).
- RP93-5—Northwest Pipeline general rate case (FERC).

Responsibilities also included the following:

- Analyses and recommendations in over fifty financing dockets involving instruments such as first mortgage bonds, medium-term notes, debentures, preferred stock, QUIDS, TOPRs, common equity, shareholder rights plans (poison pills), and derivative securities including caps, collars, and floors.
- UM 903— Northwest Natural, cost of capital analysis for purchased gas adjustment mechanism.
- UM 21—Cost of capital analysis for avoided cost calculations.
- UM 351—Cost of capital analysis for long-run incremental-cost studies.
- UM 573—Analysis of purchased power on the utility's cost of capital.
- UM 773—Cost of capital analysis for long-run incremental-cost studies.
- UM 814—Enron's application to acquire Portland General Electric Co.
- UM 918—Scottish Power plc's application to acquire PacifiCorp.

- UM 967—Sierra Pacific Resource's application to acquire Portland General Electric Co.