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BEFORE THE ARIZONA CORPORATION COMMISSION

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IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY, 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 SUN CITY WATER DISTRICT.

Docket No. W-01303A-07-0209

Arizona Corporation Commission
DOCKETED
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## EXCEPTIONS OF THE RESIDENTIAL UTILITY CONSUMER OFFICE

The Residential Utility Consumer Office ("RUCO") makes the following Exceptions to the Recommended Opinion and Order ("ROO") on Arizona American Water Company's ("Arizona American" or "Company") application for a rate increase.

### FIRE FLOW IMPROVEMENT PROJECTS

The ROO recommends the approval of a Fire Flow Cost Recovery Mechanism ("FCRM") which would allow the Company to recover the $5.1 million the Company estimates it will cost for the fire flow improvement projects. The Company will only voluntarily make the improvements if the Commission approves the FCRM, which is a non-traditional approach to rate-making which, from the ratepayer's perspective is fraught with peril. The Commission should not allow for cost recovery for the fire flow projects and should not allow recovery through the FCRM.

### 1) THE COMMISSION SHOULD NOT ALLOW FOR COST RECOVERY FOR THE FIRE FLOW PROJECTS

The fire flow projects are discretionary and should not be paid for by ratepayers. RUCO does not take issue with the contention that the discretionary improvements ensure public safety, are necessary, or that some ratepayers support the improvements[1]. The fact that the improvements ensure public safety, are arguably necessary and are supported by some ratepayers does not answer the question of **who** should pay for them. These points, at best, provide a reason why the Sun City District needs to improve its fire flow system and not the reason why ratepayers should be the ones to pay for discretionary fire flow improvements.

Perhaps the reason why neither the ROO, Staff nor the Company have provided a reason why ratepayers should pay for fire flow improvements is because it comes down to nothing more than a policy call. In this time of soaring utility rates in every sector the Commission regulates it is poor policy to require ratepayers to pay a surcharge that is not a necessary cost of service. The Commission, on numerous occasions, has stated the need for utilities to "cut the fat out" and pass through to ratepayers expenditures that are only necessary for the provision of service. The Commission should remain steadfast and consistent and reject the ROO's recommendation.

[1] In truth, the evidence in the record indicates that in a survey where 3,247 customers responded, 59 percent supported the fire flow improvements and 51 percent supported including the cost in water rates. ROO at 24. By no means do these results indicate overwhelming support for the projects. ROO at 24.

The affordability of service in the Sun City District is a primary concern. It is well-known that the Sun City district is comprised of mostly senior citizens who are on fixed incomes. Most, if not all, of the ratepayers in the District are served by APS and have recently experienced several rate increases. There is another APS rate application pending before the Commission. The same ratepayers last month also received a 29.92 percent rate increase in their sewer bills. See Decision No. 70209 at 31. The Commission should not jeopardize the affordability of water in Arizona by including in customers' rates costly fire flow improvements which are not necessary in the provision of service.

**2) THE COMMISSION SHOULD NOT ALLOW RECOVERY THROUGH THE FCRM.**

The FCRM is not an appropriate mechanism for cost recovery in this case. The FCRM is similar to the Arsenic Cost Recovery Mechanism ("ACRM") in that it would afford the Company immediate cost recovery for the improvements outside of a rate case. However, like the ACRM, the FCRM lacks the type of safeguards necessary to protect the interests of ratepayers. The ACRM was considered appropriate to provide the utilities relief where the federal law had changed, and the utilities, through no choice of their own, were forced to expend large sums of money to meet the federal mandate. The parties in the ACRM cases, which included many of the same parties in the present case, recognized the unusual and extraordinary circumstances that existed at the time and joined together to come up with a solution.

The circumstances are not the same in the present case. Here, the Commission is considering the approval of improvements that clearly are not necessary for the provision of service. The Company has a choice as to whether to make the improvements, and the community is split in its support of paying for it. The inadequacies of the system date back fifty years and neither the Town of Youngstown or the governing authorities in Sun City, the entities which typically are responsible for addressing these type issues, have sought or obtained the funding necessary to remedy the inadequacies. Surely, if the situation were that dire, something would have been done before now.

The FCRM, like the ACRM, will only consider cost increases in one category of expenses and will ignore changes in revenues, cost of capital, rate base and other expense categories. The FCRM, however, will not be limited to two steps, like the ACRM. but provides for four steps. Ratepayers will not enjoy the benefits of efficiencies or other potential off-sets to costs since the sole focus of the step reviews will be the incremental fire flow costs. This is "single-issue" ratemaking and as such, the Court of Appeals in this state has recognized it is "fraught with potential abuse." See _Scates v. Arizona Corporation Commission_, 118 AZ. 531, 534, 578 P.2d 612, 615 (1978). Given the extra two steps in the FCRM, ratepayers will be subject to even more risk than is the case with the ACRM. To the extent the Commission is willing to consider such mechanisms, it should only do so under the most dire and extreme circumstances. Approving a mechanism for the recovery of discretionary projects that are not in the purview of what the Commission regulates does not qualify for this extraordinary ratemaking device.

Finally, the FCRM will allow the Company to earn a return on its investment for each year that the surcharge is in effect as well as the remaining depreciable life of the new plant that is allowed into the Company's ratebase after the Company's next rate case. The surcharge will end in 2012 with the last step increase, but ratepayers will continue to pay for the plant through the return the Company will continue to earn on the remaining undepreciated balance of the plant after it is placed into the Company's ratebase. Therefore, the surcharge will end in name only and ratepayers will continue to pay for the plant for many years[2] after the four-step surcharge mechanism has been implemented. (See A-4, Revised Exhibit TMB-1 attached hereto as Exhibit A). This is different from the Paradise Valley case where ratepayers are paying for the improvements through contributions and the surcharge ends once the plant is paid off. The FCRM is an inappropriate mechanism for the recovery of the fire flow improvements and should not be approved.

**WORKING CAPITAL EXPENSE**

The ROO recommends the Commission adopt Staff and the Company's zero cash working capital position. Neither Staff nor the Company did a lead/lag study or any type of study to determine the Company's cash working capital needs. RUCO relied on the lead/lag study the Company did in its Mohave case (Decision No. 69440 dated May 1, 2007).

RUCO has used the same approach for computing cash working capital since the Mohave case. Most recently, RUCO relied on the Mohave lead/lag study to determine its cash working capital recommendation in the Company's Sun City Wastewater and Sun City West Wastewater case (Docket No. WS-01303A-06-0491). The Commission approved the same methodology that RUCO used in the present case in the Sun Cities case in Decision No. 70209 docketed on March 28, 2008, **only** one month ago. Decision No. 70209 at 12.

The ROO does not distinguish this case from the Sun Cities' wastewater case. Rather, the ROO appears to suggest that the lead/lag study that RUCO relied on is now outdated. ROO at 7. There is no evidence in the record to suggest that the study is outdated. On the contrary, the undisputed evidence in the record shows RUCO made the necessary

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[2] 33 years in total.

adjustments to make the study applicable to this case. R-5 at 15. RUCO calculated the revenue lag study specific to this case. Id. The majority of the expenses would have no or very minimal variance among Arizona-American's Arizona districts. Id.

The Commission has often noted that the lead/lad study is the most accurate and appropriate means of measuring cash working capital requirements of a company of Arizona-American's size. Decision No. 70209. RUCO's reliance on the Company's Mohave District lead/lag study is appropriate and provides a much more accurate assessment of the Company's cash working capital requirements than a policy decision that results in a zero cash working capital recommendation. The Commission should follow its precedent and approve RUCO's methodology.

RESPECTFULLY SUBMITTED this 28th day of April, 2008.

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By Ernestine Gamble
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Secretary to Daniel Pozefsky

# EXHIBIT A

| | |
|---|---|
| **SUN CITY DISTRICT FIRE FLOW IMPROVEMENTS** | **REVISED EXHBIT TMB-1** |
| PHASING AS PER DIRECT TESTIMONY OF BRIAN K. BIESEMEYER | Page 1 of 1 |

**TRANSLATION OF 2004 CAPITAL DOLLARS TO YEAR PROJECT IS CONSTRUCTED:**
10% ANNUAL INFLATION IN 2005 AND 2006 AND 6% ANNUAL INFLATION THEREAFTER

| | | 2004 $'S | INFLATION | FUTURE $'S |
|---|---|---|---|---|
| YEAR 0 AND 1= | 2009 | **$690,960** | 1.44112936 | **$995,763** |
| YEAR 2= | 2010 | **$699,568** | 1.527597122 | **$1,068,658** |
| YEAR 3= | 2011 | **$702,934** | 1.619252949 | **$1,138,228** |
| YEAR 4= | 2012 | **$986,640** | 1.716408126 | **$1,693,477** |
| TOTAL | | **$3,080,102** | | **$4,896,126** |

**FORECASTED REVENUE REQUIREMENT USING FUTURE $'S:**

| | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|
| ORIGINAL COST RATE BASE | **$995,763** | **$1,068,658** | **$1,138,228** | **$1,693,477** |
| DEPRECIATION RATE | 3.33% | 3.33% | 3.33% | 3.33% |
| DEPRECIATION EXPENSE | $33,159 | $35,586 | $37,903 | $56,393 |
| DEPRECIATION EXPENSE NET OF TAX | $20,360 | $21,850 | $23,272 | $34,625 |
| RATE OF RETURN | 0.0798 | 0.0798 | 0.0798 | 0.0798 |
| REQUIRED OPERATING INCOME | $79,462 | $85,279 | $90,831 | $135,139 |
| OPERATING INCOME DEFICIENCY | $99,821 | $107,129 | $114,103 | $169,765 |
| GROSS REVENUE CONVERSION | 1.6286 | 1.6286 | 1.6286 | 1.6286 |
| REVENUE DEFICIENCY | **$162,569** | **$174,470** | **$185,828** | **$276,479** |
| **ACCUMULATED REVENUE DEFICIENCY** | **$162,569** | **$337,039** | **$522,868** | **$799,346** |
| **TEST YEAR CONSUMPTION SCHEDULE E-7** | **4,688,598** | **4,688,598** | **4,688,598** | **4,688,598** |
| **ADJUSTED TEST YEAR EXISTING REVENUES** | **$7,688,479** | **$7,688,479** | **$7,688,479** | **$7,688,479** |

| | 2010 | 2011 | 2012 | 2013 |
|---|---|---|---|---|
| **FORECAST OF INCREASE IN PUBLIC SAFETY S** | **2.1%** | **2.3%** | **2.4%** | **3.6%** |
| **REVENUE PER 1000 GALLONS** | **$ 0.0347** | **$ 0.0719** | **$ 0.1115** | **$ 0.1705** |