

ORIGINAL



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ARIZONA CORPORATION COMMISSION  
PROPERTY CONTROL

7 Attorneys for the Resorts

**BEFORE THE ARIZONA CORPORATION COMMISSION**

COMMISSIONERS

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

13 IN THE MATTER OF THE APPLICATION  
 14 OF ARIZONA-AMERICAN WATER  
 15 COMPANY, INC., AN ARIZONA  
 16 CORPORATION, FOR A DETERMINATION  
 17 OF THE CURRENT FAIR VALUE OF ITS  
 18 UTILITY PLANT AND PROPERTY AND  
 19 FOR INCREASES IN ITS RATES AND  
 20 CHARGES BASED THEREON FOR  
 21 UTILITY SERVICE BY ITS PARADISE  
 22 VALLEY WATER DISTRICT.

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

Docket Nos.

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

**NOTICE OF FILING REBUTTAL TESTIMONY**

Arizona Corporation Commission  
**DOCKETED**

MAY - 9 2008

DOCKETED BY *mm*

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

28

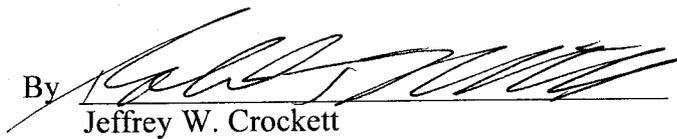
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DATED this 9th day of May, 2008.

SNELL & WILMER L.L.P.

By



Jeffrey W. Crockett  
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**ORIGINAL** and 15 copies of the foregoing  
filed this 9th day of May, 2008, with

Docket Control  
ARIZONA CORPORATION COMMISSION  
1200 West Washington Street  
Phoenix, Arizona 85004

**COPIES** of the foregoing hand-delivered  
this 9<sup>th</sup> day of May, 2008, to:

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**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, 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 NO. W-01303A-05-0405

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

DOCKET NO. W-01303A-05-0910

Rebuttal Testimony of  
**John S. Thornton**  
On Behalf of the Camelback Inn,  
Sanctuary on Camelback Mountain and the  
Renaissance Scottsdale Resort (the "Resorts")

May 9, 2008

**Rebuttal Testimony of John S. Thornton  
On Behalf of the Resorts  
Docket Nos. W-01303A-05-0405 & W-01303A-05-0910**

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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. ARE YOU THE SAME JOHN S. THORNTON WHO TESTIFIED EARLIER?**

8 A. Yes, I am.  
9

10 **II. Purpose of Testimony**

11 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

12 A. The purpose of my rebuttal testimony is to address the direct testimonies of Residential  
13 Utility Consumer Office ("RUCO") witness William A. Rigsby dated April 24, 2008, and  
14 Arizona Corporation Commission ("ACC") witness Darron Carlson dated April 25, 2008,  
15 concerning the proposed Rate Design Agreement ("RDA") in this case.  
16  
17

18 **Q. ARE YOU SPONSORING ANY EXHIBITS TO YOUR REBUTTAL**  
19 **TESTIMONY?**

20 A. No, I am not sponsoring any exhibits to my rebuttal testimony.  
21  
22

23 **III. Rebuttal to RUCO'S Testimony**

24 **Q. THE RUCO WITNESS TESTIFIES ON PAGE 8 AT LINES 3 TO 6 THAT "IN**  
25 **ADDITION, RUCO OBJECTS TO THE RATE DESIGN AGREEMENT BECAUSE IT**  
26

1 **WOULD SHIFT THE RECOVERY OF COSTS AWAY FROM HIGH USE CUSTOMERS**  
2 **- CONTRARY TO THE CONSERVATION GOALS OF THE CURRENT RATE**  
3 **DESIGN." IS THIS OBJECTION ANALYTICALLY CORRECT?**

4 A. No, this objection is not analytically correct because the current Public Safety Surcharge  
5 ("PSS") and the High Block Surcharge ("HBS") do not recover costs. Instead, they are  
6 surcharges that force customers to provide contributions in aid of construction ("CIAC") to  
7 finance investment in fire flow upgrades essentially before those expenditures are incurred.  
8 Taken to it logical conclusion, RUCO would have to support loading all costs or CIAC  
9 surcharges onto high-use customers to support the conservation goals of the current rate design  
10 but conservation goals should be balanced with just and reasonable rates for all.

11  
12  
13 **Q. WHY IS AN ADJUSTOR MECHANISM VALUABLE IN THE CONTEXT OF**  
14 **THESE FIRE FLOW COSTS?**

15 A. An adjustor mechanism is valuable in this context because the fire flow upgrade  
16 expenditures could eventually be larger than the system's current rate base (\$14,351,471 in  
17 Decision No. 68858). Traditional recovery through multiple rate cases is administratively  
18 burdensome and in any event the regulatory lag problem could be serious given the large dollar  
19 amounts involved. The lag problem might be large enough to discourage Arizona-American  
20 Water Company ("AAWC" or "Company") from making large lumpy investments in its system.  
21 Adjustor mechanisms should generally reduce the number of rate cases. Also, fire flow  
22 investment is probably best described as revenue neutral so by adding it to rates we are not  
23 committing the rate-making error of neglecting to add any associated revenues. Third, the current  
24  
25  
26

1 HBS and PSS funds can be described as going into a bank account, and when that account is big  
2 enough AAWC proceeds with a project without any current oversight. The more traditional PSS  
3 recovery mechanism proposed in the RDA and like the ACRM should accelerate fire-flow  
4 expenditures because it allows AAWC to invest as needed rather than wait for a large-enough  
5 CIAC balance to accrue. The RDA's PSS also offers an opportunity to audit new plant before it  
6 gets put into rates as the projects get completed. This audit opportunity is a safety check for  
7 consumers.  
8

9  
10 **Q. THE RUCO WITNESS TESTIFIES ON PAGE 9 AT 19 THROUGH 21 THAT**  
11 **“UNDER THE RATE DESIGN AGREEMENT, ARIZONA-AMERICAN CAN SEEK**  
12 **STEP INCREASES TO FUND FUTURE CONSTRUCTION PHASES THAT HAVE NO**  
13 **DEFINITE COST ESTIMATES AT THIS TIME.” IS RUCO CORRECT?**

14  
15 A. No, RUCO is not correct. The RDA's PSS would allow step increases to *recover* (not  
16 fund) construction that will have been put in service before recovery begins but after an audit  
17 opportunity. I do not fully understand RUCO's concern that future construction projects have  
18 definite cost estimates at this time. I doubt that the existing ACRMs in place required definite  
19 cost estimates before the ACRM mechanism itself was approved. Anyone who has been involved  
20 in a construction project is well aware of the oxymoron “definite cost estimate.”

21  
22 Moreover RUCO's concern is irrelevant because even under the current CIAC-funded  
23 surcharges there are no more or better “definite cost estimates” because we are talking about  
24 exactly the same fire-flow projects.  
25  
26

1 Q. THE RUCO WITNESS TESTIFIES ON PAGE 9 AT 21 THROUGH PAGE 10 AT 2  
2 THAT THE "BY APPROVING THE RATE CASE [SIC] AGREEMENT WITH ITS  
3 ACRM-LIKE MECHANISM THAT ALLOWS FOR AN UNSPECIFIED NUMBER OF  
4 STEP INCREASES, THE COMMISSION MAY WELL BE HANDING A BLANK  
5 CHECK TO THE COMPANY." WOULD THE RDA HAND A BLANK CHECK TO THE  
6 COMPANY?  
7

8 A. No, the RDA would not hand a blank check to AAWC. The RDA is a temporary measure  
9 that enhances ratepayer protection by providing for an audit before new plant in service is put into  
10 rate base. Practically speaking, the RDA will likely have only one step before the current rate  
11 case is resolved. I would imagine that a limit of two step increases would be suitable to AAWC  
12 since the RDA will be revisited in the general rate case and a limit on the number of steps is  
13 apparently important to RUCO. AAWC has already filed a new rate case for the Paradise Valley  
14 Water District ("PVWD") and any concerns with the number of steps or AAWC's subsequent  
15 spending on PVWD fire flow upgrades can be addressed in that case.  
16

17  
18 Q. THE RUCO WITNESS TESTIFIES ON PAGE 11 AT LINES 8 TO 10 THAT  
19 "...THE PROPOSED RATE DESIGN AGREEMENT WILL HARM THE RESIDENTIAL  
20 CLASS OF RATEPAYERS BY SHIFTING THE RECOVERY OF FIRE FLOW COSTS  
21 FROM THE HIGH-END USERS TO LOW-END USERS." IS RUCO CORRECT?  
22

23 A. No, RUCO is not correct. The proposed RDA increases no residential charge or  
24 commodity rate but it does reduce the PSS and HBS. Therefore, no current residential customer  
25  
26

1 will pay more than they are now and many will pay less. AAWC's recently filed general rate  
2 case can address any longer-term issues that concern RUCO.  
3

4 **Q. THE RUCO WITNESS TESTIFIES ON PAGE 11 AT LINES 11 TO 13 THAT**  
5 **"UNDER THE PROPOSED RATE DESIGN AGREEMENT, THE COSTS FOR THE**  
6 **FIRE FLOW IMPROVEMENTS WOULD BE RECOVERED FROM ALL OF THE**  
7 **COMPANY'S CUSTOMERS AS OPPOSED TO ONLY HIGH-END USERS." IS RUCO**  
8 **CORRECT?**  
9

10 A. No, RUCO is not correct. Currently, neither residential nor commercial customers in the  
11 first tier finance the fire flow upgrades through the PSS or HBS because neither of those  
12 surcharges apply to the first tier of either class. Under the RDA, neither the new PSS nor the  
13 reduced HBS will apply to the first tier of either class. Therefore, under the RDA the fire flow  
14 improvements would not be recovered from all of the Company's customers. The RDA only  
15 affects those tiers that are currently affected; it does not affect all of the Company's customers.  
16

17 RUCO seems to be suggesting that only high-end users should pay for the fire flow  
18 improvements that benefit everyone in the system. Effectively this means that the three Resorts,  
19 who are high-end users under the current rate design, should be significantly paying for fire flow  
20 improvements that benefit all customers, 93 percent of whom are residential.  
21

22  
23 **Q. SHOULD ONLY HIGH-END USERS PAY FOR FIRE FLOW IMPROVEMENTS?**  
24  
25  
26

1 A. No, all who benefit from the fire flow improvements should pay for their costs. The  
2 notion that those who derive the benefit of a utility service should pay its cost is a basic principle  
3 of rate making.  
4

5  
6 **Q. THE RUCO WITNESS TESTIFIES ON PAGE 11 AT LINES 16 TO 17 THAT**  
7 **“THE NEW RATE DESIGN WOULD ALSO SPREAD THE COST TO MANY**  
8 **RATEPAYERS WHO ARE NOT AFFECTED UNDER THE CURRENT RATE DESIGN.”**  
9 **IS RUCO CORRECT?**

10 A. No, RUCO is not correct. My previous answers explain how the RDA only lowers those  
11 surcharges on tiers that are currently affected by the PSS or HBS. The RDA does not propose  
12 changing any monthly charges nor does it affect residential or commercial rates in the first tier.  
13 Therefore, the RDA will not spread costs to many current ratepayers who are not affected by the  
14 current rate design.  
15

16 However, the RDA will appropriately spread costs to future ratepayers, including three  
17 new major resorts that are expected to come online in three to five years. The increased volumes  
18 from the new resorts should help reduce everyone’s burden in years to come.  
19

20  
21 **Q. THE RUCO WITNESS TESTIFIES ON PAGE 12 AT LINES 1 TO 4 THAT**  
22 **“...THE RATE DESIGN AGREEMENT PROPOSES THAT, IN THE COMPANY’S**  
23 **NEXT RATE CASE, [CIAC PROCEEDS FROM THE HBS] WOULD BE TREATED AS**  
24 **INVESTMENT THAT WOULD EARN A RETURN.” IS RUCO CORRECT?**

25  
26

1 A. No, RUCO is not correct. The RDA does not intend that AAWC earn a return on any  
2 CIAC including CIAC accumulated through the HBS. The RDA's PSS proposes a return of and  
3 on fire-flow investment that AAWC invests in its system.  
4

5  
6 **Q. THE RUCO WITNESS TESTIFIES ON PAGE 12 AT LINES 15 TO 17 THAT**  
7 **"...RUCO DOES NOT BELIEVE THAT PARADISE VALLEY RATEPAYERS WILL BE**  
8 **ANY BETTER OFF UNDER THE PROPOSALS CONTAINED IN THE RATE DESIGN**  
9 **AGREEMENT." DO YOU SHARE THIS BELIEF?**

10 A. No, I certainly do not share this belief. I understand that RUCO was established to  
11 represent the interests of *residential* utility ratepayers in rate-related proceedings involving public  
12 service corporations before the ACC. Presumably, RUCO is referring only to residential  
13 ratepayers. Yet, the RDA does benefit current residential customers. Moreover, RUCO's  
14 testimony provides no quantitative analysis of why PVWD customers will not be any better off.  
15 Residential customers will be better off when three new major resorts come online in three to five  
16 years and those new resorts can help shoulder the burden of the fire-flow improvements, reducing  
17 residences' burden. The RDA helps spread the costs out over time to those who benefit from the  
18 upgrades.  
19

20  
21  
22 **Q. IN YOUR DIRECT TESTIMONY YOU ALERT THE COMMISSION TO THE**  
23 **EFFECT OF THE PSS AND HBS ON THE RESORTS GIVEN THE COMMERCIAL**  
24 **400,000 GALLON PER MONTH SECOND TIER BREAK AND HOW THAT BREAK IS**  
25  
26

1 **LOW RELATIVE TO THE RESORTS' CONSUMPTION. WHY DOESN'T THE RDA**  
2 **PROPOSE A CHANGE IN THE TIER BREAK FOR THE COMMERCIAL CLASS?**

3 A. A change to the tier break for the commercial class would likely have resulted in  
4 recalculation of revenues and rates and perhaps a shift of revenue requirement from the  
5 commercial class to residential class. The RDA intends that some ratepayers be better off and  
6 that no ratepayer be worse off. The Resorts are probably a unique-enough consumer that they  
7 should have their own class of service beyond "commercial." The question of a distinct class of  
8 service should be resolved in a general rate case rather than in an amendment to an existing order.  
9 The intent of the RDA, from the Resorts' perspective, was that no other class of consumer would  
10 be in a worse position or negatively impacted.  
11

12  
13 **IV. Rebuttal to Staff's Testimony**

14 **Q. THE STAFF WITNESS TESTIFIES ON PAGE 4 AT LINE 6 THAT "THE**  
15 **RESORTS CHOSE NOT TO INTERVENE" [IN THE ORIGINAL RATE CASE]. CAN**  
16 **YOU PLEASE PROVIDE SOME PERSPECTIVE ON WHY THE RESORTS DID NOT**  
17 **INTERVENE?**  
18

19 A. Yes, I can. The Resorts did not intervene because they had no reason to intervene based  
20 on notices in the case. In fact they had sufficient reason pursuant to notice to avoid the cost of  
21 intervention. I suspect that Staff is now fully aware of the notice issue but I'd like to make sure  
22 that the issue is memorialized here. The Resorts are professionally run businesses that depend on  
23 clear and sufficient notice in order to understand the potential impact of new rates on their costs.  
24  
25  
26

1 Q. COULD THE RESORTS' GENERAL MANAGERS HAVE ANTICIPATED THE  
2 POTENTIAL RATE EFFECTS OF THE ORIGINAL RATE CASE BASED ON NOTICES  
3 IN THIS CASE?

4 A. No, they could not have reasonably anticipated the rate effects of the original rate case  
5 because the notices that were provided did not alert them to the potential effects of the HBS or  
6 PSS. The lack of adequate notice supports amending Decision No. 68858 by adopting the RDA.  
7 Two notices were provided and I will discuss each one in turn.  
8

9  
10 **The Original Notice**

11 Q. DID THE ORIGINAL NOTICE ADEQUATELY ALERT THE RESORTS TO THE  
12 POSSIBILITY OF TWO HUNDRED TO TWO HUNDRED THIRTY PERCENT RATE  
13 INCREASES?

14 A. No, it did not. The original notice read in relevant part,

15 "The Company's request would **increase average 5/8-inch and 3/4-inch residential**  
16 **customers' base rates by approximately 9 percent.** The Company is also seeking the  
17 Commission's approval of: a public safety surcharge for investments by the Company  
18 related to improvement of fire flow facilities; an arsenic cost recovery mechanism for  
19 investments required by the Company to comply with federal water arsenic reduction  
20 requirements; and approval of a conservation surcharge that would be imposed for usage  
21 in the highest consumption block. The actual amount of the Company's proposed rate  
22 increase varies depending on the customer's usage and the zone in which the customer is  
23 located."  
24 (emphasis added).

25 The original notice only indicated that the rate increase sought would be 9%. There was no  
26 quantification for the PSS, ACRM or HBS. A reasonable business person reading the notice  
would have anticipated a general rate increase of approximately 9 percent consistent with the  
residential impact. The Resorts' business decision not to intervene in the rate case was based

1 upon its reliance on the notice. Nowhere in the notice was information provided that would  
2 reasonably lead the Resorts to conclude that a two-hundred-percent-plus rate increase was sought  
3 and that intervention would be necessary.  
4

5 **AAWC's Brian Biesemeyer Notice**

6 **Q. DID AAWC'S LATER COMMUNICATION TO ITS CUSTOMERS**  
7 **ADEQUATELY ALERT THE RESORTS TO THE POSSIBILITY OF TWO HUNDRED**  
8 **TO TWO HUNDRED THIRTY PERCENT RATE INCREASES?**

9 A. No, it did not. AAWC witness Miles H. Kiger's Exhibit MHK-1 is a letter by Brian  
10 Biesemeyer, P.E., General Manager of the Company, sent to customers on September 6, 2005 and  
11 docketed on September 16, 2005. That letter alerts readers to a 5.4% base rate increase and  
12 represents the effect of the full rate increase including the PSS and the ACRM to be a \$62.70  
13 increase over the next five years for the typical customer. It also discusses the Arsenic Cost  
14 Recovery Mechanism and the Public Safety Surcharge in their own paragraphs. However, the  
15 letter of notice fails to mention the proposed \$2.15 HBS that far exceeds the \$1.57 Commercial  
16 Tier 2 base rate of water requested. The only warning about the HBS is a reference to a  
17 "conservation surcharge" in a trailing paragraph under the base rate increase paragraph rather  
18 than in its own titled paragraph and no dollar figure is provided. As far as one could tell, that  
19 conservation surcharge could refer to the incremental rates that already exist in the final  
20 conservation tiers.  
21  
22  
23

24 **Q. WERE THE OMISSIONS OF NOTICE ECONOMICALLY PREJUDICIAL TO**  
25 **THE RESORTS?**  
26

1 A. Yes, the notices' omissions were economically prejudicial to the Resorts' interests. The  
2 Resorts would have intervened had they been informed of the serious economic impact these  
3 surcharges would have on their water budgets.  
4

5  
6 **Q. THE STAFF WITNESS TESTIFIES ON PAGE 5 AT LINES 7 TO 10 THAT**  
7 **"...THE HIGH BLOCK USAGE SURCHARGE WAS CREATED TO ENCOURAGE**  
8 **WATER CONSERVATION IN THE HIGH-USE PVWD BY TRANSFERRING MORE**  
9 **COSTS TO THE HIGH USERS IN THE SYSTEM. THE COMMISSION, IN DECISION**  
10 **NO. 68858, ALLOWED USE OF THE HIGH BLOCK USAGE SURCHARGE FOR THE**  
11 **PERIOD OF CONSTRUCTION OF THE FIRE FLOW PROJECTS ONLY." DO YOU**  
12 **AGREE WITH THIS DESCRIPTION OF THE HBS?**

13  
14 A. I do not entirely agree with this description of the HBS. First, the HBS does not transfer  
15 costs; it is an arbitrary non-cost-of-service based surcharge that forces current ratepayers to up-  
16 front fund investment projects that will last for decades. The HBS is not a cost-recovery  
17 surcharge. Second, the HBS is not limited to the period of fire-flow construction. The HBS' life  
18 is indefinite (unique in my twenty years as a regulator). Decision No. 68858, page 39 at  
19 paragraphs 31 and 32, does not limit the HBS' life. Therefore, the HBS is an arbitrary and  
20 indefinite surcharge that will simply increase CIAC to generally offset future rate base, incurred  
21 for fire flow or otherwise.  
22

23  
24 **V. Conclusion**

25 **Q. PLEASE SUMMARIZE YOUR CONCLUSIONS AND RECOMMENDATION.**  
26

1 A. The Commission should adopt the RDA and amend Decision No. 68858 to provide  
2 immediate rate relief for commercial and residential customers. Such amendment will result in  
3 more just and reasonable rates for all PVWD customers, present and future.  
4

5  
6 **Q. DOES THIS CONCLUDE YOUR PRE-FILED REBUTTAL TESTIMONY?**

7 A. Yes, it does.  
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