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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 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

Arizona Corporation Commission
DOCKETED
JUN 13 2008
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Closing Brief
On Behalf of the Camelback Inn,
Sanctuary on Camelback Mountain and the
Renaissance Scottsdale Resort

June 13, 2008

Closing Brief
Docket Nos. W-01303A-05-0405; W-01303A-05-0910

Table of Contents

I. INTRODUCTION

The Camelback Inn, Sanctuary on Camelback Mountain ("Sanctuary") and the Renaissance Scottsdale Resort ("Renaissance") (collectively the "Resorts"), through undersigned counsel, hereby file their Closing Brief. The Resorts 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[1]) and the Resorts within the Town affected by Decision No. 68858. The Settlement Agreement is a consensus rate design entered into between the parties identified above and would act as an interim solution which would mitigate the rate shock that has occurred from Decision No. 68858 (July 28, 2006). Approval of the Settlement Agreement by the Commission would result in immediate and needed rate relief for all effected ratepayers in Paradise Valley, including the Resorts.

II. CASE HISTORY

This case arises from the Commission's Decision No. 68858 issued on July 28, 2006, in Arizona American Water Company ("AAWC") Paradise Valley Water District's ("PVWD") last rate case, Docket No. W-01303A-05-0405. Subsequent to that date, concerns were raised by the Town, several resorts and Paradise Valley residents regarding the combined impact of the various surcharges. As a result, there have been numerous discussions, meetings, and filings regarding the following two surcharges: 1) the High Block Usage Surcharge ("HUS"); and 2) the Public Safety Surcharge ("PSS").

On January 16, 2008, the Town submitted the Settlement Agreement to the Commission. Other signatories to the Settlement Agreement included the Camelback

[1] Camelback Estates II Housing Association, Clearwater Hills Improvement Association, and Finisterre HOA.

Estates II Housing Association, Clearwater Hills Improvement Association, and Finisterre HOA (collectively "Petitioning Parties"). On February 27, 2008, the Commission voted to reconsider Decision No. 68858 pursuant to A.R.S. §40-252.

On March 14, 2008, a Procedural Order was issued requiring the Petitioning Parties to file testimony supporting the Settlement Agreement. The Settlement Agreement requests that the Commission reduce the HUS from the current $2.15 per 1,000 gallons of usage to $1.00 per 1,000 gallons of usage. It also requests elimination of the current PSS which is set at $1.00 per 1,000 gallons of usage. Additionally, the Settlement Agreement requests that a new PSS be implemented in the future in an Arsenic Cost Recovery Mechanism ("ACRM") step-like fashion. The Settlement Agreement also requests changing the accounting treatment of funds received from the PSS after March 1, 2008, from "contributions" to "revenues".

III. <u>DECISION NO. 68858 HAS RESULTED IN RATE SHOCK FOR THE RESORTS.</u>

AAWC PVWD current rates were approved in Commission Decision No. 68858 (July 28, 2006). (TR Exhibit 2 at 2 [Thornton]). Decision No. 68858 increased annual forecasted water bills to the Resorts in approximately the following degrees:

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

(*Id.* at 3-4). The primary causes of the rate increase to the Resorts were the implementation of a HUS of $2.15 and a PSS of $1.00 (compared to the approximate $1.56 commercial Tier 2 cost of water). (*Id.* at 3). Unintended rate shock effects on the Resorts was caused by applying the HUS and PSS to the second of only two commercial tiers (which is set at only 400,000 gallons) and setting the second commercial tier at an unusually low breakpoint for the Resorts' water needs (as opposed to a more traditional commercial establishment).[2] (*Id.* at 4).

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. (*Id.* at 2). The Sanctuary, the Camelback Inn and the Renaissance use approximately 3,300,000, 5,700,000 and 3,500,000 gallons on average per month, respectively. (TR Exhibit 2 at 6 [Thornton]). Based upon the Resorts' unique characteristics, they have certain unavoidable minimum water needs that far exceed 400,000 gallons per month. (*Id.*). For example, The Camelback Inn can accommodate approximately 23,870 guest nights per month. (*Id.* at 8).

As a result, the HUS does not achieve any intended conservation goals but arbitrarily penalizes the Resorts for unavoidable water use despite the Resorts' demonstrated best efforts to conserve water. (TR Exhibit 1 at 2 [Scatena]). At a minimum, tier breaks should consider the Resorts' basic health and safety needs and could consider other rate class minimums including the residential class. (TR. Exhibit 2 at 6 [Thornton]).

The top residential Tier 3 begins at 80,000 gallons per month. (*Id.* at 7). The top commercial Tier 2 rate begins at consumption above 400,000 gallons per month, or only the equivalent of 5 residences. (*Id.*). However, the Resorts can host hundreds of families a night and they must serve hundreds of employees. (*Id.* at 8).

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

[2] For example, the Camelback Inn's main six-inch meter has metered about 4,000,000 gallons per month on average over the past five years. By setting the HUS and PSS at only 400,000 gallons per meter per month, the HUS applies to ninety percent of the Camelback Inn's consumption through its six-inch meter, on average, rather than to any particularly high block of consumption. (TR Exhibit 2 at 5 [Thornton]).

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

(*Id.* at 8). Clearly, the Resorts' health and safety needs far exceed five times a typical residence's needs given that resorts provide services for so many more customers and employees than could be expected of an average residence's occupants. (*Id.*).

Establishing an arbitrary "one-size-fits-all" tier of 400,000 gallons without taking into consideration the unique water needs of a resort, including a resort's relative size compared to other customers, serves no well-designed conservation purpose and arbitrarily penalizes the Resorts despite their best efforts made toward conservation. (*Id.* at 6).

In addition, the implementation of the PSS and HUS has resulted in the Resorts suffering a competitive disadvantage to resorts located in the City of Phoenix or City of Scottsdale. The following chart identifies the monthly water costs for 4,000,000 gallons through a six-inch meter under the rate schedules for AAWC PVWD, the City of Phoenix and the City of Scottsdale:

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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[3]	**$13,876**
The City of Scottsdale[4]	**$12,274**

(Id. at 9). And although the current HUS and PSS are designed to effectively pre-fund or finance PVWD's fire flow infrastructure upgrades through contributions in aid of construction ("CIAC") over the next four years or so, in approximately four years, three new resort properties will come online in the PVWD: Mountain Shadows, Montelucia, and the Ritz Carlton. (*Id.* at 10). Therefore, the Resorts will have funded most of the infrastructure upgrades that could benefit their three new competitors who will not have to pay for the upgrades. *(Id.*).

IV. <u>THE RESORTS ARE EXCELLENT STEWARDS IN CONSERVING WATER.</u>

As set forth above, establishing an arbitrary tier of 400,000 gallons without taking into consideration the unique water needs of a resort serves no well-designed conservation purpose and arbitrarily penalizes the Resorts despite their bes t efforts made towards conservation. (*Id.* at 6). The Resorts have identified many conservation efforts made including the following: 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

[3] City of Phoenix water rates include a $44.38 (inside city) fixed monthly charge for a six-inch meter (including gallons of water depending on the month) and seasonal but non-tiered rates. (*Id.* at 9).
[4] City of Scottsdale water rates include a $320.76 fixed monthly charge for a six-inch meter and three tiers of rates, the highest tier beginning at 6,250,000 gallons per month. (*Id.*).

policies; and seasonal and climactic adjustment. (TR Exhibit 1 at 3 [Scatena]). Specifically, the Camelback Inn extensively employs xeriscape landscaping around its 118 acre resort property to avoid watering in those areas. (*Id.* at 4). Of the Camelback Inn's 118 acres, 16% has no landscaping and only 4% of the acreage (or less than 5 acres) is in grass. (*Id.*). Between 1996 and 2008, the Camelback Inn has expended over $1,248,368 in conservation efforts and has realized estimated water savings of 22,751,118 gallons annually. (TR Exhibit 4).

In addition, the Camelback Inn has invested in a Rain Bird Stratus Golf Central Control System, which is a state-of-the-art electronic irrigation system that is the most advanced in the world. (TR Exhibit 1 at 3 [Scatena]). The Camelback Inn's system has distributed valves that water different vegetation differently in that older trees are irrigated once every two weeks while other plants are watered according to their minimum needs. (*Id.*). In addition, the landscape manager can control the entire irrigation system remotely by laptop 24 hours a day so that if any leaks are detected at the resort, maintenance personnel can contact her and she can immediately shut off valves to conserve water. (*Id.* at 5). Throughout the resort, the Camelback Inn uses drip irrigation wherever possible. (*Id.*).

The Camelback Inn has installed recirculation pumps in all guest rooms at the resort, which provide hot water instantly, at a savings of approximately 1 1/2 gallons of water every time a hot water faucet is turned on. (*Id.*). Back in 1996, the Camelback Inn was the first resort in the industry to remove the standard 4 gallon flush toilet with a power flush toilet that use compressed air and 1.6 gallons of water per flush, saving 3.4 gallons per use. (*Id.* at 5 – 6). The Camelback Inn also installed new shower heads that regulate water flow, which save approximately 20 to 25 gallons of water per 10 minutes of shower time. (*Id.* at 6). The Camelback Inn also installed Perlator economy flow aerators that regulate the flow of sink water in guest rooms to 1.5 GPM; equips all public space restrooms with Toto or American Standard sensor faucets, urinals and toilets; and, replaced the main kitchen Hobart dish washer with a Champion dish washer that saves approximately 55% in water and energy usage and is ENERGY STAR [5] compliant. (*Id.*).

The Camelback Inn also implemented a stringent weigh-in process for laundry to ensure that the proper pounds are put into washers to maximize the useful life of the equipment and maximize the efficiency of water used per cycle; a linen recycle program in which bed sheets are changed out every 3 days of the same guest's stay as opposed to changing the sheets everyday while the guest occupies the room; and initiated a water treatment program that enables it to cut back on cooling tower water use that saves approximately 1,500 gallons of water per month. (*Id.* at 7).

The Sanctuary invested approximately $500,000 between 2005 and 2006 to upgrade its water infrastructure, including more efficient irrigation systems, despite the fact that it

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[5] ENERGY STAR employs strategies that in the aggregate use a minimum of 20 percent less potable water than the indoor water use baseline calculated for a building, after meeting the Energy Policy Act of 1992 fixture performance requirements. In addition, ENERGY STAR promotes the use of efficient landscaping and irrigation strategies, including water reuse and 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.

is almost entirely xeriscaped. (*Id.* at 8). Because the Sanctuary has approximately 0.58%, or less than 1%, of its square footage in grass, there is essentially nothing more that the Sanctuary can do to reduce turfed areas. (*Id.*).

The Renaissance has a new landscape maintenance service that is specifically charged with reducing water use through conservation, improved irrigation maintenance, drip irrigation, and elimination of overspray. (*Id.*). The property also has extensive xeriscape and low-water-use vegetation. (*Id.*). In addition, much of the property's guest rooms are shut down during the off-season so that no water or energy is used to service those portions of the property. (*Id.*). Many pools and spas are not heated during the off season, thereby reducing evaporation. (*Id.*). The Renaissance also invested in Eco-Lab's Formula-1 laundry control system that reduces rinse and flush cycles, lowering water use by 11% and has implemented conservation programs such as encouraging guests to reuse linens and towels during their stay. (*Id.*). All guest rooms at The Renaissance have been fitted with new low-flow shower heads that reduce use of hot water by 10%. (*Id.*). Both the Camelback Inn and the Renaissance conserve water pursuant to Marriott's guide for best practices that mandates a specific energy conservation program, including conservation of water. (*Id.*).

V. <u>APPROVAL OF THE SETTLEMENT AGREEMENT IS IN THE PUBLIC INTEREST.</u>

The Settlement Agreement resulted from months of work and incorporates the viewpoints and concerns of numerous stakeholders expressed throughout the negotiation process. (TR Exhibit 2 at 3 [Thornton]). The Settlement Agreement provides that the HUS be reduced from $2.15 to $1.00 per thousand gallons and that the PSS be converted to a revenue-requirement-based surcharge from a CIAC-based surcharge. (*Id.*). The PSS would initially be eliminated and AAWC would file surcharge requests similar to its ACRM filings as new fire flow improvement projects became used and useful. (*Id.*). The new PSS would apply to the same commodity portion of rates as it does currently. (*Id.*). Therefore, no ratepayer will be worse off and may, including the Resorts, will be better off.

The Settlement Agreement would provide needed rate relief and restore a certain amount of rate fairness by reducing the HUS to $1.00 and converting the PSS to a traditional revenue-requirements surcharge. (*Id.* at 9). As described above, the Resorts will have funded most infrastructure upgrades that could benefit their three new competitors who will not have to pay for the upgrades. (*Id.* at 10). This inequity is a dramatic example of the "intergenerational transfer problem" that should be avoided when setting regulated rates. (*Id.*). Those who enjoy the benefit (of fire flow upgrades for example) in any given year should pay the cost and since the benefit of the new fire flow upgrades will be enjoyed over many decades, the cost should be borne over many decades. (*Id.*). The Settlement Agreement mitigates the intergenerational transfer problem caused by the existing HUS and PSS by more fairly distributing the costs of such improvements among current and future customers while supporting the beneficial goals of providing needed fire flow improvements and encouraging water conservation. (*Id.*). So instead of accelerating the finance requirements on current customers, it spreads the recovery of those investments over the lives of the assets in rates so that those who benefit in 30 or 40 years from these upgrades will be paying for them. (Tr. Vol. II at 249 [Thornton]). The Settlement Agreement moves the surcharge into a traditional revenue requirement rate base rate-of-return model so that those who get the benefit of those upgrades will pay their cost. (*Id.* at 250-251 [Thornton]). By depreciating those assets (transmission mains and hydrants) through the surcharge over the life of the assets, the cost will be spread out over the next 30 to 50 years. (*Id.* at 251 [Thornton]). So instead of making customers pay contributions to finance the fire flow system over the next four years, which is what the current PSS does, it transitions that to a surcharge that includes the lives of the underlying assets and prices that in a surcharge over the next 40 to 50 years, whatever the lives are. (*Id.* at 252 [Thornton]).

In addition, the Settlement Agreement will benefit residential customers because no rate will be higher than it is currently but residential tiers two and three will be lower. (TR Exhibit 2 at 10 [Thornton]). Moreover, the Settlement Agreement helps to mitigate the intergenerational problem caused by the current HUS and PSS as the current HUS and PSS force current residential customers to finance the upgrades through about four years of CIAC though the benefits of the upgrades will be enjoyed for decades.[6] (*Id.* at 11).

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[6] In addition, according to at least one resident at the public comment portion of the hearing, Decision No. 68858 also harmed conservation efforts in at least one community. Water bills have been so high under the new surcharges that conservation efforts have been eliminated. (Tr. Vol. I at 21-22 [Roberstson]).

The Resorts envision the new PSS to work very much like the ACRM. (Tr. Vol. II at 239 ([Thornton]). The ACRM schedules are already in the docket and the new PSS would be filed in the same way. *(Id.).* The new PSS would not include any O&M calculation; only the investment or rate base addition of the fire flow upgrades would be included. *(Id.).* The PSS would maintain the critical element of an earnings test and would mirror the same process as the ACRM, except the investment would be for fire flow. *(Id.).*

RUCO makes a number of assertions regarding the Settlement Agreement, but none of these statements are supported by the facts. RUCO contends that the Settlement Agreement would shift the recovery of costs away from high use customers, contrary to the conservation goals of the current rate design, but this assertion cannot be supported because the current PSS and HUS are not designed to recover costs. (TR Exhibit 3 at 2 [Thornton]). Instead, they are surcharges that force customers to provide contributions in aid of construction ("CIAC") to finance investment in fire flow upgrades essentially before those expenditures are incurred. (*Id.*). Contrary to RUCO's assertion that future construction phases that have no definite cost estimates, the Settlement Agreement's PSS would allow step increases to *recover* (not fund) construction that will have been put in service before recovery begins but after an audit opportunity. *(Id.).* In addition, the Settlement Agreement's ACRM-like mechanism is not a blank check to the Company but a temporary measure that enhances ratepayer protection by providing for an audit before new plant in service is put into rate base. *(Id.* at 4). In any event, the Company has filed a rate case for the PVWD and any concerns that RUCO has regarding the Company's subsequent spending for fire flow can be addressed in that docket. (*Id.*).

Contrary to RUCO's contention that the Settlement Agreement will harm the Residential class of ratepayers by shifting the recovery of fire flow costs from high-end users to low end users, the Settlement Agreement as proposed by the Resorts will not increase the residential charges or the commodity rate but will reduce the current PSS and HBS. (*Id.* at 4 – 5). It was the Resorts' intent that the new surcharge only be applied where the current PSS is being applied. (Tr. Vol. II at 224-225 ([Thornton]). Therefore, no current residential customer will pay more than they pay now, and many will pay less. (TR Exhibit 3 at 5 [Thornton]). In fact, the RUCO witness admitted on the stand that under the Resort proposal, in which no residential customer will be worse off by the Settlement Agreement, provided clarification that alleviated some of RUCO's concerns regarding the Settlement Agreement. (Tr. Vol. II at 289 [Rigsby]). Currently, neither residential nor commercial customers in the first tier finance the fire flow upgrades through the PSS or HUS because neither of those surcharges apply to the first tier of either class. (TR Exhibit 3 at 5 [Thornton]). Under the Settlement Agreement, neither the new PSS nor the reduced HUS will apply to the first tier of either class, therefore, the fire flow improvements would not be recovered from all of the Company's customers as suggested by RUCO. (*Id.*). The Settlement Agreement only affects those tiers that are currently affected by the PSS and the HUS; it does not affect all of the Company's customers. (*Id*).

RUCO also seems to suggest that only high-end users should pay for the fire flow improvements that benefit everyone in the system. (*Id.*). However, all who benefit from the fire flow improvements should pay for their costs. (*Id.* at 6). The notion that those who derive the benefit of a utility service should pay its cost is a long established principle of rate making. *(Id.)*.

Finally, RUCO asserts that PVWD customers will not be any better off under the Settlement Agreement but provides no financial analysis to support this claim. (*Id.* at 7). At a minimum, Residential customers will be better off when three new major resorts come online in three to five years and they can help shoulder the burden of the fire-flow improvements, reducing residents' burdens and it is undisputed that the Settlement Agreement helps spread the costs out over time to those who benefit from the upgrades. (*Id.*).

VI. CONCLUSION.

Approval of the Settlement Agreement will mitigate the deleterious financial impact to the Resorts and other customers resulting from the HUS and PSS implemented by AAWC under Decision No. 68858. (TR Exhibit 1 at 10 [Scatena]). Regardless of what the surcharges are, the Resorts have demonstrated through their past actions as well as testimony in this case that they will continue to do what they can to save on the resources and save on costs, as it is the responsible thing to do. (Tr. Vol. I at 75 [Scatena]). The Resorts submit that the current rate structure imposes unreasonable rates on them and can have a negative effect on capital spending. (*Id.*).

The Commission should adopt the Settlement Agreement's principles and amend Decision No. 68858 as it will result in immediate rate relief for all customers, both commercial and residential, and such amendment will result in more just and reasonable rates for all PVWD customers. (TR Exhibit 2 at 11 [Thornton]).

RESPECTFULLY SUBMITTED this 13th day of June, 2008.

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