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Transcript Exhibit(s)

Docket #(s): W-01303A-05-0405

W-01303A-05-0910

AZ CORP COMMISSION
DOCKET CONTROL

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Exhibit #: A1, A2, T1, T2, TR1-TR3, RUCO1, RUCO2,

S1, S2, Mundell1, Mundell2.

Arizona Corporation Commission
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To: Docket Control

Re: Arizona-American Water W-01303A-05-0405, et al.
Volumes I and II Concluded
May 15 and 16, 2008

STATUS OF ORIGINAL EXHIBITS

FILED WITH DOCKET CONTROL
06-03-2008

STAFF (S Exhibits)

1, 2

ARIZONA-AMERICAN (A Exhibits)

1, 2

RUCO

1, 2

TOWN OF PARADISE VALLEY (T Exhibits)

1, 2

THE RESORTS (TR Exhibits)

1, 2, 3

MUNDELL (Mundell Exhibits)

1, 2

LATE-FILED EXHIBITS

ARIZONA-AMERICAN (A Exhibits)

3, 4, 5

THE RESORTS (TR Exhibits)

4

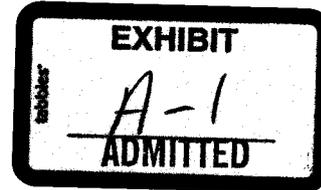
Copy to:

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AZ-American (Paul M. Li, Esq.)
The Resorts (Robert Metli, Esq.)
Town of PV (Timothy J. Casey, Esq.)
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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 DISTRICT

DOCKET NO. W-01303A-05-0405

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

DOCKET NO. W-01303A-05-0910

**DIRECT TESTIMONY
OF
MILES H. KIGER
ON BEHALF OF
ARIZONA-AMERICAN WATER COMPANY
APRIL 25, 2008**

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TABLE OF CONTENTS

I	INTRODUCTION AND QUALIFICATIONS	1
II	PURPOSE OF TESTIMONY.....	2
III	BACKGROUND OF THE HIGH BLOCK AND PUBLIC SAFETY SURCHARGES	2
IV	RATE DESIGN AGREEMENT.....	4
V	ACCOUNTING ORDER (DECISION NO. 68303).....	7
VI	OTHER MATTERS.....	8

- MHK - 1** Letter from Brian Biesemeyer to Paradise Valley customers dated September 9, 2005
- MHK - 2** Anticipated Public Safety Surcharge Based on the Estimated Cost of Phase 3 of the Fire Flow Improvement Projects
- MHK - 3** Impact of Rate Design Agreement on Residential Customers with 5/8 and 1-inch meters and Commercial Customers with 2-inch and 6-inch meters

1 **I INTRODUCTION AND QUALIFICATIONS**

2 **Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND TELEPHONE**
3 **NUMBER.**

4 A. My name is Miles H. Kiger. My business address is 19820 N. 7th Street, Suite 201,
5 Phoenix, AZ 85024, and my telephone number is 623-445-2492.

6 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

7 A. I am employed by American Water Service Company as a Rate Analyst for the Western
8 Region, including Arizona-American Water Company ("Arizona-American").

9 **Q. PLEASE OUTLINE YOUR RESPONSIBILITIES FOR ARIZONA-AMERICAN**
10 **AS A RATE ANALYST.**

11 A. As a rate analyst, my primary responsibilities are to prepare rate applications and other
12 regulatory filings. I recently prepared all the required schedules and the filing for Step-
13 Two ACRM applications for the Paradise Valley and Havasu Water Districts.

14 **Q. HAVE YOU PARTICIPATED IN THE PREPARATION OF RATE CASE**
15 **APPLICATIONS IN OTHER JURISDICTIONS?**

16 A. Yes. I recently prepared a water and sewer rate application for Texas American Water
17 Company. As the assigned rate analyst on that case, I prepared all the rate base and
18 operation and maintenance (O&M) expense schedules, reviewed all the notices to the
19 customers, and ensured that the approved rates were properly implemented.

20 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.**

21 A. I received a Master of Science degree in Agricultural & Resource Economics from the
22 University of Arizona in 2007 and a B.S. and B.A. from the University of Massachusetts
23 at Amherst in 2003.

1 Q. **HAVE YOU PREVIOUSLY TESTIFIED BEFORE THIS COMMISSION?**

2 A. No.

3 **II PURPOSE OF TESTIMONY**

4 Q. **WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS CASE?**

5 A. The primary purpose of my testimony is to explain how the existing rates in Paradise
6 Valley Water District ("PV") will change if the relief requested by the Town and resorts
7 is granted.

8 **III BACKGROUND OF THE HIGH BLOCK AND PUBLIC SAFETY**

9 **SURCHARGES**

10 Q. **PLEASE DESCRIBE THE HIGH BLOCK AND PUBLIC SAFETY**
11 **SURCHARGES.**

12 A. In Decision No. 68858 ("Decision"), the Commission approved the PV Public Safety and
13 High Block surcharges for the purposes of funding fire flow improvements and
14 encouraging water conservation. Residential customers with usage in the second and
15 third tier (over 25,000 gallons/month) and commercial customers with usage in the
16 second tier (over 400,000 gallons/month) are assessed a Public Safety Surcharge ("PSS")
17 in the amount of \$1.00 per 1,000 gallons per month. To further the Commission's goal of
18 water conservation, a High Block Surcharge ("HBS") of \$2.15 per 1,000 gallons per
19 month applies to residential usage in the third tier (over 80,000 gallons/month) and
20 commercial usage in the second tier (over 400,000 gallons/month). Proceeds from the
21 HBS and PSS are presently treated as Contributions in Aid of Construction ("CIAC") to
22 offset the construction expense associated with the Fire Flow Improvement Projects
23 ("FFIP") in PV.

1 **Q. DID ARIZONA-AMERICAN NOTIFY ITS CUSTOMERS ABOUT A PROPOSED**
2 **SURCHARGE TO FUND THE FFIP LONG BEFORE THE COMMISSION**
3 **ISSUED DECISION NO. 68858?**

4 A. Yes. Exhibit MHK- 1 provides a letter from then Arizona-American General Manager
5 Brian Biesemeyer to all Paradise Valley customers dated September 9, 2005.¹ The letter
6 communicates to the affected customers, among other things, the reasons for the FFIP,
7 the planned \$16 million capital expense (but not the forecasted rate amount) attributable
8 to the FFIP, and the surcharge funding mechanism for the FFIP.

9 **Q. WHAT IS THE AMOUNT OF HIGH BLOCK AND PUBLIC SAFETY**
10 **SURCHARGE PROCEEDS GENERATED AS OF MARCH 31, 2008?**

11 A. As of March 31, 2008, the two surcharges generated \$2,687,213 in CIAC, of which
12 \$2,262,945 came from HBS and \$424,268 came from PSS.

13 **Q. HOW MUCH FFIP RELATED EXPENDITURE HAS ARIZONA-AMERICAN**
14 **INCURRED AS OF MARCH 31, 2008?**

15 A. As of March 31, 2008, Arizona-American has spent \$5,835,077 on FFIP related
16 construction in PV.

17 **Q. TO DATE, HOW MUCH OF THE FFIP RELATED EXPENDITURE HAS BEEN**
18 **INCLUDED IN PV'S RATE BASE AND, THEREFORE, IS NOT SUBJECT TO**
19 **RECOVERY VIA THE SURCHARGES?**

20 A. In Decision No. 68858, the Commission approved \$3,018,867 FFIP related investment in
21 PV's rate base. This left a remaining net balance of \$2,816,210 construction cost and
22 \$317,909 in deferred depreciation expense and post-in-service AFUDC at March 31,

¹ The letter was also filed in this docket on September 16, 2005.

1 2008 to be funded by proceeds from surcharges. Therefore, the present remaining
2 amount of phases 1 and 2 of the FFIP to be recovered via surcharge is \$446,906.

3 **IV RATE DESIGN AGREEMENT**

4 **Q. DOES ARIZONA-AMERICAN SUPPORT THE AGREEMENT FILED BY THE**
5 **TOWN OF PARADISE VALLEY ON JANUARY 16, 2008?**

6 A. Arizona-American supports most of the provisions in the Rate Design Agreement
7 (“RDA”) filed by the Town on January 16, 2008 except the second sentence of Section
8 A, the last sentence of Section C, and Section D.

9 **Q. WHAT IS THE PURPOSE OF THE RDA?**

10 A. From the perspective of the customers, the RDA provides an immediate rate reduction
11 until a final order is effective in Arizona-American’s next PV rate case. An important
12 aspect of the RDA from Arizona-American’s perspective is the conversion of the Public
13 Safety surcharge from being accounted for as CIAC to being accounted for as revenue.
14 The surcharge mechanism to fund the FFIP remains revenue neutral under the RDA,
15 therefore the fair value finding made in Decision No. 68858 can be used here.

16 **Q PLEASE DESCRIBE THE RDA.**

17 A. The RDA decreases the HBS to \$1.00 per 1,000 gallons of consumption from \$2.15 per
18 1,000 gallons of consumption. The proceeds from the HBS will remain as CIAC used to
19 offset FFIP’s related construction and financing costs. The RDA also initially resets the
20 existing PSS to \$0.00 per 1,000 gallons from \$1.00 per 1,000 gallons until later approval
21 of a generic “ACRM-like” PSS step increase with a specific step increase filing in late
22 2008. The first PSS step increase request will be based on the actual costs incurred
23 during Phase 3 of the FFIP (construction scheduled to be completed by October 2008)
24 plus the unrecovered construction and authorized deferral costs of the FFIP, if any, from

1 earlier phases, minus the forecasted HBS proceeds through September 2009. Approval of
2 subsequent PSS step increases will be requested in the next PV rate case. Each step
3 increase is subject to an earning test using the most recent Commission approved return
4 on equity for PV. Like an ACRM, the Commission Staff and other interested parties will
5 have the ability to review Arizona-American's PSS step increase request.

6 **Q WHAT ARE THE ESTIMATED PROCEEDS FROM THE HIGH BLOCK**
7 **SURCHARGE UNDER THE RDA?**

8 A. The amount of proceeds from the HBS under the RDA is projected to be \$772,100 for the
9 13-month period from the anticipated conclusion of this case to September 2009, or the
10 anticipated date for the new PV rates. Arizona-American will be requesting the HBS
11 cease in the next PV rate case.

12 **Q. SECTION D. OF THE RDA STATES THE NEW HIGH BLOCK SURCHARGE IS**
13 **TASKED WITH RECOVERING 50% OF THE FFIP INVESTMENT. DOES THE**
14 **CURRENT FORECAST SUPPORT THIS ASSUMPTION?**

15 A. No. The cost estimate for Phase 3 of the FFIP is \$3,720,000. The projected proceeds of
16 \$772,100 from the HBS will only recover approximately 21% ($\$772,100/\$3,720,000$) of
17 Phase 3 of the FFIP costs.

18 **Q. WHAT IS THE ESTIMATED PUBLIC SAFETY SURCHARGE UNDER THE**
19 **RDA?**

20 A. Exhibit MHK - 2 estimates that the first step of the PSS will be roughly \$0.10 per 1,000
21 gallons of consumption. It is very important the Commission's order in this case
22 authorizes a PSS Step increase filing as part of approving the RDA or we will not have a
23 means to timely recover Phase FFIP costs. If we do not have a timely recovery, my
24 management informs me we cannot proceed with further FFIP construction.

1 **Q. WHAT IMPACT DOES THE RDA HAVE ON DIFFERENT CUSTOMER**
2 **CLASSES?**

3 A. As you can see from Exhibit MHK – 3, residential customers with usage in tiers 2 and 3
4 will see a decrease in their monthly bills from 14.41% to 36.30% and commercial
5 customers with usage in tier 2 will see a decrease in their monthly bills from 10.68% to
6 37.88%. There is no change for the residential and commercial customers with usage
7 only in tier 1.

8 **Q. WHAT EFFECT DOES THE RDA HAVE ON THE REPAYMENT PERIOD OF**
9 **THE FFIP?**

10 A. Under the RDA, Arizona-American will recover its remaining FFIP related investment
11 over a period up to 40 years, matching the average life of the FFIP related assets. The
12 revenue requirements accounting under the RDA extends the repayment period much
13 longer than the existing CIAC accounting.

14 **Q. CAN ARIZONA-AMERICAN ACCELERATE THE CONSTRUCTION OF THE**
15 **NEXT PHASE OF THE FFIP UNDER A REVENUE REQUIREMENTS**
16 **ACCOUNTING?**

17 A. Probably, but that depends on many factors, including the outcome of this case. Under
18 the existing CIAC accounting, my management sets spending limits for each phase of the
19 FFIP at the projected annual amount of surcharges proceeds. The conversion of the PSS
20 to a revenue requirements accounting effectively lifts the spending limits and allows
21 Arizona-American to reexamine and possibly accelerate each phase of the FFIP in light
22 of all the project's technical parameters, spending priorities and available capital budget
23 as part of its annual planning process. Arizona-American's capital project planning
24 process is already underway for year 2009 and beyond based on the assumption the RDA
25 will be approved. There is a small chance that, even without the spending limit, the future

1 phases of the FFIP will not be accelerated if there are too many capital demands for the
2 scarce capital budget.

3 **V ACCOUNTING ORDER (DECISION NO. 68303)**

4 **Q. PLEASE DESCRIBE THE ACCOUNTING ORDER AUTHORIZED BY**
5 **DECISION NO. 68303 AND SUBSEQUENTLY MODIFIED BY DECISION NO.**
6 **68858.**

7 **A.** In Decision No. 68303, the Commission granted Arizona-American's request for an
8 accounting order authorizing the deferral of FFIP depreciation expense and deferral of
9 post-in-service allowance for funds used during construction ("AFUDC"). The
10 accounting order, later modified by Decision No. 68858, limits the authorized deferral to
11 only the net investment in the FFIP after the application of CIAC collected via
12 surcharges.

13 **Q. WHAT IS THE NET BALANCE OF THE AUTHORIZED MODIFIED**
14 **DEFERRAL AS OF MARCH 31, 2008?**

15 **A.** As of March 31, 2008, the net balance of the authorized deferral is \$317,909. The
16 deferral balance consists of \$200,863 in post in-service AFUDC, and \$117,046 in
17 depreciation expense at an average rate of 1.99%.

18 **Q. HAVE THE PROCEEDS FROM THE SURCHARGES BEEN APPLIED TO THE**
19 **DEFERRED DEPRECIATON EXPENSE AND POST-IN-SERVICE AFUDC?**

20 **A.** Not yet, but the deferral is expected to be recovered via the PSS and HBS soon as the
21 remaining phase 1 and phase 2 construction costs are anticipated to be recovered in the
22 next few months.

23 **Q. MIGHT THE AUTHORIZED DEFERRAL BE AN ISSUE IN THE NEXT RATE**
24 **CASE?**

1 A. Yes. If the deferral is not fully recovered by the time of the next PV rate case's hearing
2 or not otherwise fully included in the next PSS step increase or if any party is interested
3 in its calculation, this can be addressed in the next PV rate case.

4 **VI OTHER MATTERS**

5 **Q. HAS ARIZONA-AMERICAN FILED ITS PARADISE VALLEY ACRM STEP-**
6 **TWO INCREASE APPLICATION?**

7 A. Yes. In addition to showing the monthly bill reductions attributable to the RDA, Exhibit
8 MHK – 3 also includes the impact of the recently filed PV ACRM Step-Two surcharge
9 on customers' monthly bills, for full disclosure purposes.

10 **Q. IS ARIZONA-AMERICAN FILING A NEW RATE CASE SOON FOR THE**
11 **PARADISE VALLEY WATER DISTRICT?**

12 A. Yes. The details of this new rate case should be available prior to the May 15, 2008,
13 hearing on this matter.

14 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

15 A. Yes.



September 6, 2005

Dear Valued Paradise Valley Water District Customer,

Although the Consumer Price Index has increased 19.2% during the past seven years, Arizona American Water has not increased your base water rates since 1998. In 2004, the Company commenced a six-year capital expenditure program that will result in improved customer health, safety, and welfare by removing more arsenic from drinking water and improving water flow and pressure for fire-fighting activities.

Due to this capital improvement program of more than 35 million dollars, we recently filed a rate increase request with the Arizona Corporation Commission. Arizona American Water requested these rate increases become effective late summer 2006.

If approved, the requested rates would include a 5.4 percent increase in the "Basic Service" rate, and two new surcharges titled, "Arsenic Cost Recovery Mechanism" and "Public Safety." For the typical customer using approximately 22,000 gallons of water per month, the average monthly bill before taxes would increase \$62.70 over the next five years. This monthly increase would be phased in annually based on Arizona American Water's capital expenditures.

The information below gives an overview of improvements in your quality of service.

Federal Mandate Requires Increased Drinking Water Quality

Arsenic Cost Recovery Mechanism

Arizona American Water has proposed a surcharge to underwrite capital improvements necessary to comply with the new federal drinking water standard.

New federal regulations, effective in 2006, require public and private water providers to make significant investments in the treatment of drinking water to permit no more than 10 parts per billion of arsenic, whereas the current federal standard permits up to 50 parts per billion. Water tests in your district's water supplies detected levels ranging from 8 to 18 parts per billion—well below the old standard but somewhat higher than the new.

This unfunded federal mandate requires Arizona American Water to invest more than 19 million dollars for new drinking water treatment facilities in the Paradise Valley Water District. These improvements, currently under construction at 6237 North Cattletrack Road in Scottsdale, include the installation of new piping, filtration fixtures, pumps, and other infrastructure needed for enhanced drinking water treatment. If you would like to learn about public health benefits identified by the US Environmental Protection Agency, then please visit the agency's website at <http://www.epa.gov/safewater/arsenic.html>.

Protecting Your Lives and Investments with Better Fire Protection

Public Safety Surcharge

Arizona American Water has also proposed a surcharge related to public safety improvements. This surcharge is intended to underwrite capital expenditures necessary to enhance fire protection for customers and their property.

Arizona American Water implemented the first stages of the Paradise Valley Fire Flow Improvement Program in 2004 and 2005. This program was spearheaded by the Town of Paradise Valley and Arizona American Water in response to concerns from customers and the Town regarding the fire safety and protection of residents' lives and property.



Brian Biesemeyer
Arizona General Manager

Arizona American Water
Paradise Valley Water District
7500 E McDonald Rd, Ste 102A
Paradise Valley, AZ 85351

T 623-445-2400
F 480-483-8314
I www.amwater.com



In July 2003, Arizona American Water formed Paradise Valley Users Group in order to understand all the fire protection concerns and to solicit customer input to use in formulating possible solutions. The Users Group included citizens from various areas in the district, business representatives, Town elected officials and staff, as well as Arizona American Water representatives and consultants. After months of concerted effort, the Users Group and Arizona American Water established a six-year program for improving Paradise Valley Water District fire protection systems.

Since then, Arizona American Water began implementing the 16 million dollar Paradise Valley Fire Flow Improvement Program. We have acted proactively, addressing specific immediate needs by completing the Jackrabbit-Invergordon Main Replacement and the Tatum-McDonald Realignment; both improvements were identified in the plan. However, due to the magnitude of the continuing investments, Arizona American Water will need approval of this surcharge in order to timely proceed with the balance of the program.

Operations, Maintenance and Improvements of Older Systems

Base Rate Increase of 5.4%

The first of Arizona American Water's Paradise Valley Water District infrastructure was put into service more than half a century ago. This system requires ongoing delivery improvements, replacements, and an aggressive preventative maintenance program. In addition to these operational and maintenance improvements, Arizona American Water, like any other company, is faced with inflationary market conditions.

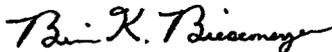
The Company's proposal also includes a conservation surcharge for residential customers using more than 80,000 gallons per month and commercial customers using more than 400,000 gallons per month. If you meet these criteria and would like to know the potential conservation charges you may see in your monthly bill, please contact Arizona American Water.

What's next?

The Arizona Corporation Commission will hold a public hearing relating to this rate increase request on March 27, 2006.

Thank you for taking time to learn more about what Arizona American Water is doing to improve the service we provide to you. Arizona American Water is committed to our customers' health and welfare, and is constantly working to ensure your water system is reliable and safe. If you have any questions, comments, or wish to learn how your monthly bill may be impacted, please feel free to contact me or Rob Antoniak, Community Relations (623-815-3112, rob.antoniak@amwater.com).

Sincerely,



Brian K. Biesemeyer, P. E.
General Manager

Arizona-American Water Company
 Paradise Valley Water District
 Public Safety Surcharge Calculation

Line No.	Growth	(A)	(B)	(C)	(D)	(E)	(F)
1	Dec. 2006 (Year 1)	Customers	Total Gallons Sold	Gallons Sold Per Cust.			
2	Dec. 2007 (Year 2)	4,726	3,077,899	651.27			
3	Year 2 minus Year 1	4,750	3,065,644	645.40			
4	Percentage Change	24	(12,255)	(6)			
5	Avg Gallons (Col B Ln 1 + Col B Ln 2 + 2)	0.51%	-0.40%	-0.90%			
6			3,071,772				
7							
8							
9							
10	Meter Size	Average Customers at Dec. 2007	Estimated Customers at Dec. 2008	Estimated Average Customers	Monthly Minimum	Minimum Multiples	Equivalent Meters
11	5/8-inch	2,390	2,402	2,396	\$ 24.34	1.0	2,396
12	3/4-inch	32	32	32	25.18	1.0	33
13	1-inch	2,019	2,029	2,024	40.60	1.7	3,376
14	1.5-inch	75	75	75	81.98	3.4	253
15	2-inch	267	268	268	130.65	5.4	1,437
16	3-inch	23	23	23	242.09	9.9	229
17	4-inch	1	1	1	402.85	16.6	17
18	6-inch	5	5	5	806.97	33.2	166
19							
20							
21	Total	4,812	4,836	4,824			7,908
22							
23							
24							
25	Calculation of Public Safety Surcharge		Commodity Surcharge				
26	Total costs to be recovered	\$ 304,694	\$ 304,694				
27	Commodity Revenue (Col A Ln 26)						
28							
29	Monthly Increment Per Equivalent Meter		3,071,772				
30	Average Gallons (Col B Ln 5)						
31							
32	Public Safety Surcharge (Col B Ln 27 + Ln 30)						\$ 0.0992
33							

RESIDENTIAL 5/8"

<u>Gallons Consumption</u>	<u>Previous</u>	<u>Existing Rates</u>	<u>Existing plus ACRM Step 2</u>	<u>Settlement Proposal</u>	<u>Dollar Increase (Proposal - Previous)</u>		<u>Dollar Increase (Proposal - Existing plus ACRM Step 2)</u>	
					<u>\$</u>	<u>% Increase</u>	<u>\$</u>	<u>% Increase</u>
0	\$ 9.50	\$ 24.34	\$ 26.76	\$ 26.76	\$ 17.26	181.7%	\$ -	0.00%
5,000	13.30	30.41	33.20	33.20	19.90	149.6%	-	0.00%
10,000	17.10	36.47	39.64	39.64	22.54	131.8%	-	0.00%
25,000	28.50	54.68	58.96	58.96	30.46	106.9%	-	0.00%
50,000	69.75	157.26	163.42	138.42	68.67	98.4%	(25.00)	-15.90%
75,000	111.00	259.85	267.87	217.87	106.87	96.3%	(50.00)	-19.24%
100,000	162.85	396.03	405.92	307.92	145.07	89.1%	(98.00)	-24.75%
150,000	271.85	685.20	698.83	493.33	221.48	81.5%	(205.50)	-29.99%
200,000	380.85	974.37	991.73	678.73	297.88	78.2%	(313.00)	-32.12%
250,000	489.85	1,263.54	1,284.64	864.14	374.29	76.4%	(420.50)	-33.28%
300,000	598.85	1,552.71	1,577.54	1,049.54	450.69	75.3%	(528.00)	-34.01%
350,000	707.85	1,841.88	1,870.45	1,234.95	527.10	74.5%	(635.50)	-34.50%
400,000	816.85	2,131.05	2,163.35	1,420.35	603.50	73.9%	(743.00)	-34.87%
1,000,000	2,124.85	5,601.09	5,678.21	3,645.21	1,520.36	71.6%	(2,033.00)	-36.30%

RESIDENTIAL 1"

<u>Gallons Consumption</u>	<u>Previous</u>	<u>Existing Rates</u>	<u>Existing plus ACRM Step 2</u>	<u>Settlement Proposal</u>	<u>Dollar Increase (Proposal - Previous)</u>		<u>Dollar Increase (Proposal - Existing plus ACRM Step 2)</u>	
					<u>\$</u>	<u>% Increase</u>	<u>\$</u>	<u>% Increase</u>
0	\$ 15.85	\$ 40.60	\$ 43.02	\$ 43.02	\$ 27.17	171.4%	\$ -	0.00%
5,000	19.65	46.67	49.46	49.46	29.81	151.7%	-	0.00%
10,000	23.45	52.73	55.90	55.90	32.45	138.4%	-	0.00%
25,000	34.85	70.94	75.22	75.22	40.37	115.8%	-	0.00%
50,000	76.10	173.52	179.68	154.68	78.58	103.3%	(25.00)	-14.41%
75,000	117.35	276.11	284.13	234.13	116.78	99.5%	(50.00)	-18.11%
100,000	169.20	412.29	422.18	324.18	154.98	91.6%	(98.00)	-23.77%
150,000	278.20	701.46	715.09	509.59	231.39	83.2%	(205.50)	-29.30%
200,000	387.20	990.63	1,007.99	694.99	307.79	79.5%	(313.00)	-31.80%
250,000	496.20	1,279.80	1,300.90	880.40	384.20	77.4%	(420.50)	-32.86%
300,000	605.20	1,568.97	1,593.80	1,065.80	460.60	76.1%	(528.00)	-33.65%
350,000	714.20	1,858.14	1,886.71	1,251.21	537.01	75.2%	(635.50)	-34.20%
400,000	823.20	2,147.31	2,179.61	1,436.61	613.41	74.5%	(743.00)	-34.60%
1,000,000	2,131.20	5,617.35	5,694.47	3,661.47	1,530.27	71.8%	(2,033.00)	-36.19%

COMMERCIAL 2"

<u>Gallons Consumption</u>	<u>Previous</u>	<u>Existing Rates</u>	<u>Existing plus ACRM Step 2</u>	<u>Settlement Proposal</u>	<u>Dollar Increase</u>		<u>Dollar Increase</u>	
					<u>(Proposal - Previous)</u>	<u>% Increase</u>	<u>(Proposal - Existing plus ACRM Step 2)</u>	<u>% Increase</u>
0	\$ 51.00	\$ 130.65	\$ 133.07	\$ 133.07	\$ 82.07	160.9%	\$ -	0.00%
400,000	559.00	820.01	852.31	852.31	293.31	52.5%	\$ -	0.00%
500,000	715.00	1,336.35	1,376.12	1,161.12	446.12	62.4%	\$ (215.00)	-16.09%
1,000,000	1,495.00	3,918.05	3,995.17	2,705.17	1,210.17	80.9%	\$ (1,290.00)	-32.92%
1,500,000	2,275.00	6,499.75	6,614.22	4,249.22	1,974.22	86.8%	\$ (2,365.00)	-36.39%
2,000,000	3,055.00	9,081.45	9,233.27	5,793.27	2,738.27	89.6%	\$ (3,440.00)	-37.88%

COMMERCIAL 6"

<u>Gallons Consumption</u>	<u>Previous</u>	<u>Existing Rates</u>	<u>Existing plus ACRM Step 2</u>	<u>Settlement Proposal</u>	<u>Dollar Increase</u>		<u>Dollar Increase</u>	
					<u>(Proposal - Previous)</u>	<u>% Increase</u>	<u>(Proposal - Existing plus ACRM Step 2)</u>	<u>% Increase</u>
0	\$ 315.00	\$ 806.97	\$ 809.39	\$ 809.39	\$ 494.39	156.9%	\$ -	0.00%
400,000	823.00	1,496.33	1,528.63	1,528.63	705.63	85.7%	\$ -	0.00%
500,000	979.00	2,012.67	2,052.44	1,837.44	858.44	87.7%	\$ (215.00)	-10.68%
1,000,000	1,759.00	4,594.37	4,671.49	3,381.49	1,622.49	92.2%	\$ (1,290.00)	-28.08%
1,500,000	2,539.00	7,176.07	7,290.54	4,925.54	2,386.54	94.0%	\$ (2,365.00)	-32.96%
2,000,000	3,319.00	9,757.77	9,909.59	6,469.59	3,150.59	94.9%	\$ (3,440.00)	-35.25%

EXHIBIT

tabbies

A-2
ADMITTED

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 DISTRICT

DOCKET NO. W-01303A-05-0405

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

DOCKET NO. W-01303A-05-0910

**REBUTTAL TESTIMONY
OF
THOMAS M. BRODERICK
ON BEHALF OF
ARIZONA-AMERICAN WATER COMPANY
MAY 6, 2008**

**REBUTTAL TESTIMONY
OF
THOMAS M. BRODERICK
ON BEHALF OF
ARIZONA-AMERICAN WATER COMPANY
MAY 6, 2008**

TABLE OF CONTENTS

I	INTRODUCTION AND QUALIFICATIONS	1
II	PURPOSE OF TESTIMONY.....	2
III	THE FIRE FLOW FUNDING MECHANISM PROPOSED IN THE RATE DESIGN AGREEMENT.....	2

1 **I** **INTRODUCTION AND QUALIFICATIONS**

2 **Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND TELEPHONE**
3 **NUMBER.**

4 **A.** My name is Thomas M. Broderick. My business address is 19820 N. 7th Street, Suite
5 201, Phoenix, Arizona 85024, and my business phone is 623-445-2420.

6 **Q. IN WHAT CAPACITY AND BY WHOM ARE YOU EMPLOYED?**

7 **A.** I am employed by American Water as Director, Rates & Regulation for operations in
8 Arizona, New Mexico and Texas. Arizona-American Water Company ("Arizona-
9 American") is a wholly-owned subsidiary of American Water.

10 **Q. PLEASE DESCRIBE YOUR PRIMARY RESPONSIBILITIES FOR ARIZONA-**
11 **AMERICAN.**

12 **A.** I am responsible for water and wastewater rate cases and public utility regulation in
13 Arizona, New Mexico and Texas.

14 **Q. PLEASE DESCRIBE YOUR PROFESSIONAL EXPERIENCE AND**
15 **EDUCATION.**

16 **A.** For more than 20 years before joining Arizona-American in 2004, I held various
17 management positions in the electric-utility industry with responsibilities for regulatory
18 and government affairs, corporate economics, planning, load forecasting, finance and
19 budgeting with Arizona Public Service Company, PG&E National Energy Group and
20 Energy Services, and the United States Agency for International Development. I was
21 employed at APS for nearly 14 years as Supervisor, Regulatory Affairs, then Supervisor,
22 Forecasting, and then Manager, Planning. I was designated APS' Chief Economist in the
23 early 1990s. For PG&E National Energy Group, I was Director, Western Region-
24 External Relations. For USAID, I was Senior Energy Advisor to Ukraine.

1 I have a Masters Degree in Economics from the University of Wisconsin – Madison and
2 a Bachelors Degree in Economics from Arizona State University.

3 **Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THIS COMMISSION?**

4 A. Yes, on many occasions.

5 **II PURPOSE OF TESTIMONY**

6 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS CASE?**

7 A. The purpose of my testimony is to describe action Arizona-American has already taken in
8 response to Commission Staff's April 25, 2008, direct testimony in this proceeding and to
9 explain additional actions that will become necessary if the Commission accepts Staff
10 and RUCO's recommendation to deny the conversion of the existing Public Safety
11 Surcharge to revenue accounting and to deny authorization of an ACRM-like fire flow
12 surcharge capable of a step increase by year-end 2008.

13 **III THE FIRE FLOW FUNDING MECHANISM PROPOSED IN THE RATE**
14 **DESIGN AGREEMENT ("RDA")**

15 **Q. HAVE YOU REVIEWED THE DIRECT TESTIMONIES RECENTLY FILED BY**
16 **ALL THE PARTIES?**

17 A. Yes.

18 **Q. DO YOU HAVE A RESPONSE?**

19 A. Yes. In their direct testimonies, the Staff and RUCO both oppose the feature of the Rate
20 Design Agreement ("RDA") that converts the existing Public Safety Surcharge ("PSS")
21 to revenue accounting from Contribution in Aid of Construction ("CIAC") accounting.
22 They also oppose the authorization of an ACRM-like surcharge capable of a step increase
23 at year-end 2008. Both the revenue accounting and the step-increase proposed in the
24 RDA are essential components of the RDA from Arizona-American's perspective

1 because the proceeds from this step increase are necessary in order to begin recovery of
2 the now on-going construction costs of Phase 3 of the Paradise Valley Fire Flow
3 Improvement Project ("FFIP").

4 **Q. WHAT WOULD HAPPEN TO THE FUNDING FOR THE FFIP IF THE**
5 **COMMISSION REJECTS THE ACRM-LIKE FUNDING MECHANISM**
6 **PROPOSED IN THE RDA?**

7 **A.** Under the RDA, only the ACRM-like step increase and the re-set High Block Surcharge
8 ("HBS") provide the contemporaneous funding sources for Phases 3 and 4 of the FFIP. If
9 the Commission rejects the ACRM-like step increase mechanism, it leaves only the HBS
10 as the contemporaneous funding source for Phases 3 and 4 of the FFIP. Under the RDA,
11 the HBS is reduced to \$1.00 per 1,000 gallons from \$2.15 for residential usage exceeding
12 80,000 gallons per month and commercial usage exceeding 400,000 gallons per month.
13 The reduced HBS is inadequate to fund Phases 3 and 4 of the FFIP¹.

14 **Q. WHAT ACTION HAS ARIZONA-AMERICAN ALREADY TAKEN AS A**
15 **RESULT OF STAFF'S APRIL 25, 2008 TESTIMONY?**

16 **A.** As a direct result of Commission Staff's testimony filed on April 25, 2008, Arizona-
17 American Water suspended the construction of Phase 3B of the FFIP. Phase 3B of the
18 FFIP involves the replacement of 3,300 feet of 6-inch pipe with sixteen-inch pipe along

¹ Mr. Kiger testified in his direct testimony that the budget for Phase 3 of the FFIP is \$3,720,000. He also states that the forecasted proceeds for the reduced HBS are only \$772,100 for the anticipated 13 month period from a decision in this docket until a decision in the next Paradise Valley rate case. Mr. Kiger then explained that as of March 30, 2008, we still have \$446,906 of Phases 1 and 2 FFIP construction and associated deferrals to pay off. While we anticipate the proceeds from both existing surcharges will be adequate to pay off Phases 1 and 2 costs in the next few months, that still leaves unfunded approximately \$3 million of Phase 3 of the FFIP. It also leaves the funding of Phase 4 up in the air until the end of the next rate case.

1 Lincoln Drive between Tatum and Mountain View Roads, and an additional 1,750 feet of
2 4-inch pipe with 8-inch pipe on Tatum Boulevard between Lincoln Drive and Joshua
3 Tree Road. The budgeted construction cost for Phase 3B is \$2.3 million. The
4 Contractor, Pierson Contracting, had begun advance work relating to the construction of
5 Phase 3B and the actual construction of Phase 3B was scheduled to begin on May 22,
6 2008, with roadway trenching. Arizona-American has now ceased all work relating to
7 Phase 3B at least until the resolution of this case. The construction of Phase 3B could
8 remain suspended until 2009 (or later) if the Commission does not issue a decision
9 supporting the conversion of the PSS to revenue accounting from CIAC accounting
10 before June 30, 2008.

11 There are several reasons why, if the construction of Phase 3B is not resumed by June 30,
12 2008, it will be suspended until 2009 (or later). First, the Town of Paradise Valley
13 ("Town") limits roadway construction to the off-peak summer season when it is less
14 disruptive to traffic. Second, Pierson Contracting's supplier has informed us it will hold
15 our current order for the sixteen-inch pipe only until June 30, 2008. After that date, a
16 new order with higher cost and a later delivery date will make it impossible for Arizona-
17 American to complete the Phase 3B construction by the Town's imposed November 2008
18 deadline.

19 **Q. PLEASE DESCRIBE PHASE 3A AND ITS PRESENT STATUS.**

20 **A.** Phase 3A is nearly complete. Phase 3A involves the construction of a twenty-four-inch
21 pipeline one-half mile in length on McDonald Drive between Miller Road and Scottsdale
22 Road in Scottsdale. This pipeline will transmit the increased volumes of water from our
23 treatment plant to a location where future FFIP projects will distribute it further. Phase
24 3A's current cost estimate is \$1.4 million and it is expected to be completed in June 2008
25 by our contractor, Hunter Contracting. Phase 3A was accelerated and begun late last year

1 because the City of Scottsdale was already trenching this area for one of its own
2 underground projects. This acceleration resulted in cost savings for Phase 3A of the
3 FFIP. Phase 3A of the FFIP is too far along to be suspended and so it will be completed
4 on schedule. However, if the Commission accepts the RDA without the PSS step
5 increase mechanism, our only option for cost recovery of Phase 3A costs would be as a
6 post-test year plant addition in the new Paradise Valley rate case filed on May 1, 2008.
7 However, even if the Commission authorizes the unrecovered portion of the Phase 3A
8 costs be treated as a post-test year plant addition in the next Paradise Valley rate case, the
9 costs will not go in rates until nearly a year later than under the PSS.

10 **Q. PLEASE DESCRIBE PHASE 4 OF THE FFIP AND ITS PRESENT STATUS?**

11 **A.** Phase 4 is in design and is budgeted at \$3.1 million. The construction of this phase is
12 scheduled to begin and end in 2009. It consists of installing one quarter mile of sixteen-
13 inch pipeline on Lincoln Drive, a booster pump station at Lincoln Drive and Hillside
14 Road, and one-half mile of 8-inch pipeline on Chaparral Road between Scottsdale Road
15 and 68th Street. Phase 4 is likewise now suspended pending the outcome of this
16 proceeding.

17 **Q. IF THE COMMISSION ADOPTS STAFF AND RUCO'S POSITION OPPOSING**
18 **THE CONVERSION OF THE PSS TO REVENUE ACCOUNTING WITH AN**
19 **ACRM-LIKE INCREASE, WHEN MIGHT THE CONSTRUCTION OF PHASES**
20 **3B AND 4 OF THE FFIP RESUME?**

21 **A.** On the assumption that the Commission will re-establish the PSS or its equivalent as a
22 revenue surcharge upon the conclusion of the just filed Paradise Valley rate case in
23 September 2009, Phase 3B can resume in 2010 and Phase 4 in 2011, which will push
24 back the in-service dates of those two phases by approximately two years. To reduce the
25 delay of Phase 4, we would consider the possibility of commencing the Phase 4

1 construction in 2010. Such determination requires further evaluation of our internal
2 resource availability and consultation with the Town about multiple traffic disruptions.
3 Please keep in mind that, under this scenario, the budgets for Phases 3B and 4 will need
4 to be re-examined and the costs will escalate from the current estimates as a result of
5 delay.

6 **Q. DOES ARIZONA-AMERICAN CONTINUE TO SUPPORT THE RDA?**

7 A. We continue to support the RDA as initially proposed by the Town with the minor
8 revisions proposed by Mr. Kiger in his direct testimony. However, we do **not** support the
9 RDA with the revision proposed by the Staff which opposes the conversion of the PSS to
10 revenue accounting and denies authorization to file an ACRM-like step increase in late
11 2008. The unacceptable risk of the Commission granting the Staff proposed outcome has
12 caused Arizona-American to suspend this discretionary construction.

13 **Q. IF THE COMMISSION APPROVES THE RDA WITH THE MINOR REVISIONS**
14 **PROPOSED BY MR. KIGER IN HIS DIRECT TESTIMONY BEFORE JUNE 30,**
15 **2008, WHAT WOULD HAPPEN TO THE CONSTRUCTION OF PHASES 3B**
16 **AND 4 OF THE FFIP?**

17 A. Phases 3B and 4 will resume. Phase 3B would be completed about a month later than
18 anticipated - in November 2008. Arizona-American, of course, prefers this scenario.

19 **Q. IF THE COMMISSION DENIES ENTIRELY THE RDA BEFORE JUNE 30, 2008,**
20 **AND LEAVES THE PSS AND HBS SURCHARGES AT THEIR EXISTING**
21 **LEVELS AND CIAC ACCOUNTING, WHAT WOULD HAPPEN TO THE**
22 **CONSTRUCTION OF PHASES 3B AND 4 OF THE FFIP?**

1 A. Phases 3B and 4 will resume. Phase 3B would be completed about a month later than
2 anticipated - in November 2008. This outcome, however, would deny the rate reduction
3 several parties to this case are seeking.

4 **Q. COMMISSION STAFF WITNESS MR. CARLSON STATED THAT THE RDA**
5 **PROPOSES TO "ELIMINATE" THE PSS. IS THAT TRUE?**

6 A. No. The Section III(B) of the RDA is clear that the PSS will initially be "reset" to \$0.00
7 and "would subsequently be re-established in an 'ACRM' like step increase filings...".
8 For the record, only Mr. Carlson used the word "eliminate"

9 **Q. DOES THAT CONCLUDE YOUR REBUTTAL TESTIMONY?**

10 A. Yes.



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 DISTRICT

DOCKET NO. W-01303A-05-0405

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

DOCKET NO. W-01303A-05-0910

RATE DESIGN AGREEMENT

1 I. INTRODUCTION

2 On July 28, 2006, the Arizona Corporation Commission ("Commission") issued Decision
3 No. 68858 concerning the Paradise Valley Water District of Arizona-American Water Company
4 ("Arizona-American"). Among other things, the Decision authorized Arizona-American to
5 collect a "High Block" surcharge, as well as a "Public Safety" surcharge, to fund projects
6 needed to satisfy fire-flow requirements sought by the Town of Paradise Valley, to encourage
7 water conservation, to alleviate future rate increases for customers in the District and to slightly
8 modify Decision No. 68303 which approved an accounting order applicable to the fire-flow
9 project. On November 14, 2005, the Commission issued Decision No. 68303 which approved a
10 deferral of associated depreciation expense and post-in-service AFUDC.

1 Since the issuance of Decision No. 68858, many customers have objected to the large
2 magnitude of the rate increase imposed on high-usage accounts and timely rate relief is sought.
3 Similarly, several resorts within the Paradise Valley Water District have stated that the
4 surcharges have increased water bills to levels significantly higher than bills for resorts receiving
5 municipal water from the Cities of Phoenix and Scottsdale, thereby putting the Paradise Valley
6 resorts at a competitive disadvantage.

7 Over the last several months, representatives from Paradise Valley Homeowners'
8 Associations, the Town of Paradise Valley, Paradise Valley resorts, and Arizona-American have
9 been discussing the possible substance of an agreement that would address the various parties'
10 concerns, while preserving the Commission's three goals of funding fire-flow projects,
11 encouraging water conservation, and alleviating future rate increases. The Town of Paradise
12 Valley's preferences were expressed in its Resolution No. 1156 dated September 27, 2007.

13 This Rate Design Agreement has been reached as a result.

14 **II. PARTIES**

15 The parties to this Rate Design Agreement are described in the following table:

<u>Party</u>	<u>Description</u>	<u>Authorized Signer</u>
Town of Paradise Valley	Municipal Corporation	James C. Bacon, Jr., Town Manager
Arizona-American Water Company	Water Utility	Paul Townsley, President
Sanctuary on Camelback Mountain	Resort	Robert J. Metli, Attorney
Camelback Inn	Resort	Robert J. Metli, Attorney
Scottsdale Renaissance	Resort	Robert J. Metli, Attorney
Camelhead Estates II HOA	Homeowners' Association	Janice D. Stoney, Resident
Clearwater Hills Improvement Association	Homeowners' Association	Mary Lou Reid, Resident and Executive Director
Finisterre HOA	Homeowners' Association	David Pulatie, Resident

16 These parties may be referred to jointly as the "Parties" or individually as a "Party."

1 **III. AGREEMENT**

2 The Parties ask the Commission, pursuant to A.R.S. § 40-252, to amend Decision No.
3 68858 to implement the rate design and accounting changes described below on March 1, 2008,
4 as a transitional measure until a final order is effective in Arizona-American's next rate case for
5 the Paradise Valley Water District.¹

6 A. On March 1, 2008, reduce the High Block surcharge from \$2.15 to \$1.00
7 per 1000 gallons, but continue to account for the proceeds from this surcharge as
8 Contributions in Aid of Construction ("CIAC"). The High Block surcharge would
9 recover all un-recovered fire-flow costs incurred as of February 29, 2008, if any,
10 including the previous Commission authorized accounting cost deferrals.

11 B. On March 1, 2008, reset the existing \$1.00 per 1,000 gallons Public Safety
12 surcharge to \$0.00. The proposed Public Safety surcharge would subsequently be re-
13 established in "ACRM" like step increase filings based on actual investment costs which
14 would occur upon completion of each fire-flow construction phase, with step increases
15 subject to an earnings test of 10.4% return on equity. Therefore, the Commission can use
16 the finding of Fair Value in Decision No. 68858 to determine the Fair Value with a
17 subsequent Public Safety step increase – just as presently occurs with ACRM filings.

18 C. The Public Safety surcharge would continue to apply only to the
19 commodity portion of the rate and would very likely remain well below the existing
20 amount of \$1.00 per 1,000 gallons as a result of its conversion to a revenue requirement
21 surcharge. The first step increase filing is anticipated in late 2008 upon completion of
22 Phase 3 of Paradise Valley's fire flow project (already under construction). An
23 approximate estimate of the first step increase in the Public Safety surcharge is \$0.125
24 per 1,000 gallons. The proposed Public Safety surcharge would recover investments

¹ Arizona-American presently plans to file this rate case not later than May 2008.

1 made after March 1, 2008, under a cost recovery mechanism using a revenue
2 requirements formula instead of CIAC.²

3 D. For fire flow phases completed after March 1, 2008, the Public Safety
4 surcharge would be designed to recover 50% of the investment. The revised High Block
5 surcharge, therefore, would be allocated the remaining 50% to recover, at least until a
6 final order is effective in Arizona-American's next rate case for the Paradise Valley
7 Water District.

8 E. All other rate design features of these two surcharges and accounting
9 deferrals would remain as they presently exist until modified by a final order in Arizona-
10 American's next rate case for the Paradise Valley Water District.

11 F. The Parties will seek to complete the transition of the High Block
12 surcharge from a CIAC to a revenue-requirement formula in proposals to the
13 Commission in the next rate case. The parties will also provide the Commission with
14 proposed enhancements to the existing conservation-oriented rate design.

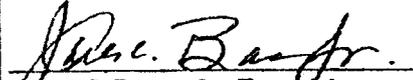
15 G. The current construction schedule for the fire-flow projects in the Paradise
16 Valley Water District is set forth in the following table:

<u>Phase</u>	<u>Start</u>	<u>Completion</u>	<u>Cost Estimate</u>
Phase 3	1/1/08	12/31/08	\$3.626 M
Phase 4	1/1/09	12/31/09	\$4.346 M
Phase 5	1/1/10	12/31/10	TBD
Phase 6	1/1/11	12/31/11	TBD
Phase 7	1/1/12	12/31/12	TBD

² As of November 30, 2007, the total un-recovered fire-flow costs remaining (including deferrals) were \$795,622. Presently, \$3,018,867 of the fire-flow costs are also in rate base and are considered recovered for purposes of determining costs to be recovered in a re-designed High Block surcharge.

V. SIGNATURES

Town of Paradise Valley


James C. Bacon, Jr., Town Manager
Dated January __, 2008

Arizona-American Water Company

Paul Townsley, President
Dated January __, 2008

Camelhead Estates II HOA

Janice D. Storey, Resident
Dated January __, 2008

Clearwater Hills Improvement Association

Mary Lou Reid, Executive Director & Resident
Dated January __, 2008

Finisterre HOA

David Pulatie, Resident
Dated January __, 2008

Sanctuary on Camelback Mountain
Camelback Inn
Scottsdale Renaissance

Robert J. Metli, Attorney in Fact
Dated January __, 2008

V. SIGNATURES

Town of Paradise Valley

Arizona-American Water Company

James C. Bacon, Jr., Town Manager
Dated January __, 2008

Paul Townsley, President
Dated January __, 2008

Camelhead Estates II HOA

Clearwater Hills Improvement Association

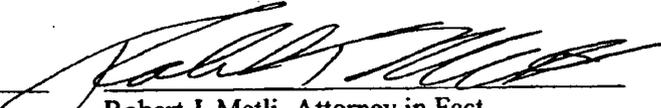
Janice D. Storey, Resident
Dated January __, 2008

Mary Lou Reid, Executive Director & Resident
Dated January __, 2008

Finisterre HOA

**Sanctuary on Camelback Mountain
Camelback Inn
Scottsdale Renaissance**

David Pulatic, Resident
Dated January __, 2008



Robert J. Metli, Attorney in Fact
Dated January 4, 2008

V. SIGNATURES

Town of Paradise Valley

Arizona-American Water Company

James C. Bacon, Jr., Town Manager
Dated January __, 2008

Paul Townsley, President
Dated January __, 2008

Camelhead Estates II HOA

Clearwater Hills Improvement Association

Janice D. Storey, Resident
Dated January __, 2008


Ermo S. Bartoletti, Resident and President
Dated January 3, 2008

Finisterre HOA

**Sanctuary on Camelback Mountain
Camelback Inn
Scottsdale Renaissance**

David Pulatie, Resident
Dated January __, 2008

Robert J. Metli, Attorney in Fact
Dated January __, 2008

V. SIGNATURES

Town of Paradise Valley

Arizona-American Water Company

James C. Bacon, Jr., Town Manager
Dated January __, 2008

Paul Townsley, President
Dated January __, 2008

Camelhead Estates II HOA

Clearwater Hills Improvement Association



Janice D. Storey, Resident
Dated January 3, 2008

Mary Lou Reid, Executive Director & Resident
Dated January __, 2008

Finisterre HOA

**Sanctuary on Camelback Mountain
Camelback Inn
Scottsdale Renaissance**

David Pulatie, Resident
Dated January __, 2008

Robert J. Metli, Attorney in Fact
Dated January __, 2008

V. SIGNATURES

Town of Paradise Valley

Arizona-American Water Company

James C. Bacon, Jr., Town Manager
Dated January __, 2008

Paul Townsley, President
Dated January __, 2008

Camelhead Estates II HOA

Clearwater Hills Improvement Association

Janice D. Storey, Resident
Dated January __, 2008

Mary Lou Reid, Executive Director & Resident
Dated January __, 2008

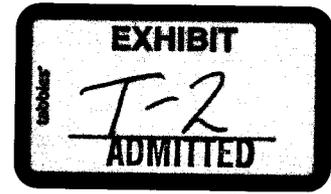
Finisterre HOA

**Sanctuary on Camelback Mountain
Camelback Inn
Scottsdale Renaissance**



David Pulatie, Resident
Dated January 3, 2008

Robert J. Metli, Attorney in Fact
Dated January __, 2008



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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, 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 NO. W-01303A-05-0405
DOCKET NO. W-01303A-05-0910

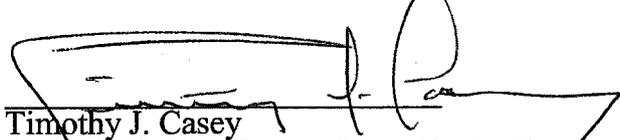
THE TOWN OF PARADISE VALLEY'S SUBMISSION OF ITS DIRECT TESTIMONY

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

Pursuant to the Order dated March 14, 2008, the Town of Paradise Valley ("Town") hereby submits its direct testimony of Councilperson Mary Hamway on the Attached Exhibit A.

RESPECTFULLY SUBMITTED this 28th day of March, 2008.

SCHMITT, SCHNECK, SMYTH & HERROD, P.C.


Timothy J. Casey
Attorney for the Town of Paradise Valley

ORIGINAL and 13 copies filed this 28th day of March, 2008, with:

Docket Control
ARIZONA CORPORATION COMMISSION

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1200 West Washington Street
Phoenix, Arizona 85004

COPIES of the foregoing mailed and emailed
this 4th day of March, 2008, to:

Teena Wolf
Chief Administrative Law Judge
Hearing Division
ARIZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, Arizona 85004

Maureen Scott
Legal Division
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1200 West Washington Street
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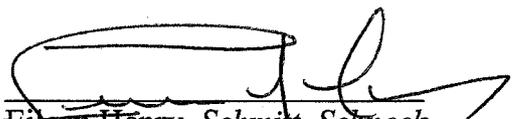
COPIES of the foregoing emailed and mailed
this 4th day of March, 2008, to:

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Smyth & Herrod, P.C.

1 In addition, the Town has learned over the past eighteen months some of the
2 factors that are taken into consideration when rate designs are prepared and can
3 now better appreciate and respect the complexities of the decisions the
4 Commission must make. The Town also now better understands its proper role in
5 rate cases, and further understands that its residents and resorts expect the Town to
6 be active participants in future rate cases.

7 **Q. WHAT ROLE DID THE TOWN PLAY IN THE RATE DESIGN**
8 **PROPOSAL SUBMITTED BY THE TOWN MANAGER ON JANUARY 15,**
9 **2008 (THE "PROPOSAL")?**

10 A. Shortly after the first Surcharge was implemented, Town officials received
11 comments from frustrated and angry residents who were shocked by the impact of
12 the first Surcharge and wanted to know what actions could be taken by the Town
13 in response to their water bill increases. Similarly, the resorts in the Paradise
14 Valley Service Area had concerns that the new rate structure in Decision No.
15 68858 did not take into account the significant economic impact on their
16 commercial properties. Hearing these concerns repeated over many months, the
17 Town brought the resorts and the residents together and served mainly as a
18 facilitator between the parties in helping develop a consensus plan, and eventually,
19 the Proposal.

20 **Q. WHAT IS THE TOWN PROPOSING AS ITS MODEST INTERIM**
21 **RELIEF?**

22 A. The Proposal rectifies in part: 1) the unintended consequences of placing the
23 resorts within the Town at a competitive disadvantage when compared to resorts
24 that are not within the Arizona American Paradise Valley Service Area; and 2) the
25 significant and unexpected rate increases incurred Town residential users. The
26 Proposal still retains significant surcharge amounts on the residential and
27 commercial customers within the Town (thus encouraging conservation by those
28 who desire to see their monthly bills lower), but spreads out the repayment
schedule. One advantage of the rate methodology in the Proposal is that spreading

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out part of the repayment schedule provides a mechanism for ensuring that future beneficiaries of the fire flow improvements, both residential and commercial, will also pay for the improvements that provide an incentive for these beneficiaries to design and implement low water use systems.

Q. WHY DOES THE TOWN BELIEVE THAT A RATE RESTRUCTURING FOR RESORTS IS NECESSARY?

A. A review of the water charges incurred by Paradise Valley resorts under Decision No. 68858 compared to the water charges of Phoenix and Scottsdale resorts allowed Town officials to conclude that resorts within the Paradise Valley Water District are paying significantly more for their water than their nearby competitors. Therefore, the Paradise Valley resorts must increase their room rates significantly to pay for their significantly increased water bills, which places them at a significant competitive financial disadvantage. Competitive disadvantages to resorts within the Town have a direct and substantial impact on the Town.

The operational success of the resorts within the Town is an essential element of the Town's economic viability and sustainability. The Town relies heavily on the bed and sales taxes paid by its resorts. These taxes provide approximately 40 percent of the Town's total revenues. Without such revenues from the resorts continuing, the Town will face revenue shortfalls and economic difficulties, which would then force the Town to reduce its services to its residents or to create new revenue sources. As a consequence, economic and competitive disadvantages experienced by the resorts within the Town have a direct economic impact not only on the Town's resorts, but also on the Town and its residents. Additionally, while the Town believes rate restructuring is necessary for the vitality of its resorts, the Proposal does balance rate increases equally and equitably between the Town's resorts and the Town's residents.

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Q. IS THE TOWN AWARE THAT ITS JANUARY 15, 2008 CONSENSUS PROPOSAL PROVIDES FOR A SLIGHT REDUCTION IN THE RATES PAID BY THE "HIGH BLOCK" RESIDENTIAL CUSTOMERS?

A. Yes. The relief provided under the Proposal is fair under the circumstances because the "high block" non-commercial residents in Paradise Valley perceive, rightly or wrongly, that the "high block" rate increase was implemented without sufficient notice and inequitably requires only the "high block" users (consisting of only 20% of the Paradise Valley customer base) to pay for the bulk of the fire-flow improvements, while all the Paradise Valley Service Area customers benefit from the fire flow improvements.

Q. WHAT ROLE DO YOU SEE THE TOWN PLAYING IN REGARDS TO THE WATER CONSUMPTION ISSUE?

A. For meaningful water conservation to occur, the Town submits that education and incentives are necessary to promote personal responsibility in water consumption. Interim relief in the form of the Proposal will allow the Town further time to review, discuss, and implement meaningful water conservation measures intended to strongly encourage "high block" residential customers to conserve water. These potential measures can include such items as providing various incentive measures for increased water conservation, decreased water consumption, and/or the introduction of rebates for the removal of turf lawns and the installation of native Sonoran vegetation similar to the rebate program offered by the City of Scottsdale.

I DECLARE UNDER PENALTY OF PERJURY, PURSUANT TO RULE 80(i), ARIZONA RULES OF CIVIL PROCEDURE, THAT THE FOREGOING IS TRUE AND CORRECT TO THE BEST OF MY KNOWLEDGE. EXECUTED ON MARCH 28, 2008

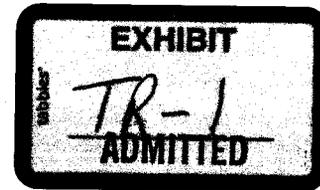

MARY HAMWAY

BEFORE THE ARIZONA CORPORATION COMMISSION

**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.**

**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-05-0405



DOCKET NO. W-01303A-05-0910

Direct Testimony of

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

March 28, 2008

Direct Testimony of Ralph Scatena

Table of Contents

Introduction 1
Summary of Testimony and Recommendations 2
Efforts by the Resort to Conserve and Reserve Water 8
Conclusion 9

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 and the Scottsdale Renaissance Resort (the "Resorts"). My testimony will support the 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 ("Settlement Agreement"). 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.

II. SUMMARY OF TESTIMONY

Q. PLEASE SUMMARIZE YOUR TESTIMONY.

A. My testimony will specifically focus on why the High Usage Surcharge ("HUS") arbitrarily penalizes and unfairly impacts the Resorts. Specifically, by setting the second tier at 400,000 gallons, this "conservation surcharge" does not take into

consideration the unique water use characteristics of a large resort and applies standards that may be more appropriate for a conventional commercial customer. As a result, the implementation of the HUS does not achieve the intended conservation goals, but unfairly penalizes the Resorts for water use despite the Resorts' exemplary efforts to conserve water. As described below, based upon the Resorts efficiency investments and practices, the Resorts are at the forefront of water conservation.

In addition, Resort Witness John Thornton will discuss the deleterious financial impact to the Resorts resulting from the various surcharges implemented by AAWC under Decision No. 68858 and the subsequent rate shock that resulted. As discussed by Mr. Thornton, Decision No. 68858 resulted in the unintended and inequitable increase to water rates for the Sanctuary of 234%, or an additional \$154,905 per year; for the Camelback Inn of 221%, or an additional \$221,173 per year; and for the Scottsdale Renaissance of 191%, or an additional \$106,601 per year.

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

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

- A. It is my understanding that the purpose of a conservation surcharge is to promote prudent and responsible water usage. To do this, the Commission implements a surcharge, on a per gallon basis, for those gallons used that the Commission believes exceed a threshold amount that the Commission determines to be prudent usage. Customers in this category are assessed a surcharge for all gallons used that exceed this threshold amount in an effort to persuade those customers to curtail their usage.

In this case, the HUS threshold for commercial consumption was set arbitrarily at 400,000 gallons per month. The Sanctuary, the Camelback Inn and the Scottsdale Renaissance use approximately 3,700,000, 5,700,000 and 3,256,250 gallons on average per month, respectively. Based upon the Resorts unique characteristics, they have certain minimum water needs that far exceed 400,000 gallons per month. For example, each Resort can host approximately 300 families a night. In contrast, the residential conservation threshold was set at 80,000 gallons per month. I don't believe anyone in this case would argue that 5 residential properties equal one resort ($80,000 \times 5 = 400,000$). To provide some additional perspective, the Camelback Inn covers 118 acres, while a typical residential home in Paradise Valley covers one acre. At a minimum, tier breaks should have some relation not only to the Resorts basic health and safety needs, but have a reasonable relation to other classifications including the residential class. Establishing an arbitrary "one-size-fits-all" tier of 400,000 gallons without taking into consideration the unique water needs of the Resorts including their relative size, number of rooms and amenities, serves no conservation purpose and arbitrarily penalizes the Resorts despite the efforts made towards conservation as discussed below.

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

- A. In meetings with the other General Managers of the Resorts, we have identified several of the conservation efforts already being made by the Resorts, 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 policies; and seasonal and climactic adjustment.

Q. WHAT IS XERISCAPE LANDSCAPING?

- A. Xeriscape landscaping is landscaping which minimizes supplemental irrigation. The ADWR has identified seven principles of xeriscaping which we attempt to follow. A copy of ADWR's principles is attached as Exhibit A.

Q. PLEASE DESCRIBE THE CAMELBACK INN'S EFFORTS TO REPLACE HIGH WATER USE PLANTS AND GRASS WITH XERISCAPE LANDSCAPING.

- A. The Camelback Inn extensively employs xeriscape planting around its 118 acre resort property to avoid watering in those areas. 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. During remodeling at The Camelback Inn in 2003 and 2007, grassy areas were converted into xeriscape landscaping whenever possible. The end results was that over 2 acres of grass was converted into xeriscape landscaping, a reduction in turf of approximately 29%.

Q. PLEASE DESCRIBE THE CAMELBACK INN'S EFFORTS TO UPGRADE AND IMPROVE ITS IRRIGATION MANAGEMENT SYSTEMS AND INFRASTRUCTURE.

- A. 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 irrigation system in the world. The Camelback Inn's system has distributed valves that water different vegetation differently. For example, older trees are irrigated once every two weeks while other plants are watered according to their minimum needs. This gives The Camelback Inn the ability to regulate water flow to all of our plant life to prevent over watering in areas that don't require water on a regular basis. Without this system all vegetation would receive the same amount of water. In addition, the landscape manager can control the

entire irrigation system remotely by laptop from anywhere in the world so that if any leaks are detected at the resort, the personnel can contact her and she can immediately shut off valves to conserve water. Our landscape manager also has the ability to shut down the entire system via laptop when rain is detected in the area. We are currently looking into a monitoring system that would allow the system to shut itself down if it detects rain. In addition, throughout the resort, The Camelback Inn use drip irrigation wherever possible.

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

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

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

In addition, back in 1996, The Camelback Inn was the first resort in the industry to remove the standard 4 gallon flush toilets, replacing them with power flush toilets that use compressed air and 1.6 gallons of water per flush saving 3.4 gallons per flush. The Camelback Inn also installed new shower heads that regulate the water flow while enabling guests to enjoy an adequate high pressure shower. A test run shows that these new heads save approximately 20 – 25 gallons of water per 10

minutes of shower time as compared to the old style shower heads. The Camelback Inn also installed Perlator economy flow aerators that regulate the flow of sink water in guest rooms to 1.5 GPM and still produce an inviting flow for guest needs. All public space restrooms are equipped with Toto or American Standard sensor faucets, urinals and toilets to avoid unnecessary water waste. The Camelback Inn also replaced the main kitchen Hobart dish washer with a Champion dish washer, which saves approximately 55% in water and energy usage and is ENERGY STAR¹ compliant.

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

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

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

- A. Yes. At The Camelback Inn, the Chief Engineer conducts a weekly walk around to look for any leaks or dripping faucets that need repair to avoid wasting water. In addition, The Camelback Inn has 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. The Camelback Inn has also implemented a linen recycle program, in which bed sheets

¹ 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.

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. This is a significant saving in water for laundry. In addition, The Camelback Inn has implemented a water treatment program that enables it to cut back on cooling tower water use, which saves approximately 1,500 gallons of water per month.

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

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

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

A. Taking into account the basic increases as well as the two surcharges, The Camelback Inn's water rates have gone up approximately 221%, or an additional \$221,173 per year. As a result, this puts us at a competitive disadvantage to those resorts served by municipal providers or other private water companies that have not experienced this type of increase.

Q. ARE YOU FAMILIAR WITH THE EFFORTS OF THE SANCTUARY AND SCOTTSDALE RENAISSANCE WITH REGARD TO WATER CONSERVATION?

A. I have had some discussions with the General Managers of these two resorts and can offer a brief overview. It is my understanding that The Sanctuary has invested approximately \$500,000 between 2005 and 2006, to upgrade its water infrastructure, including more efficient irrigation systems, despite the fact that it is

almost entirely xeriscaped. In addition, The Sanctuary has approximately 0.58%, or less than 1%, of its square footage in grass. Thus, there is essentially nothing more that The Sanctuary can do to reduce turfed areas.

The Scottsdale Renaissance has a new landscape maintenance service that is charged with reducing water use through conservation, improved irrigation maintenance, drip irrigation, and elimination of overspray. The property also has extensive xeriscape and low-water-use vegetation. 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. In addition, pools and spas are not heated during the off season, thereby reducing evaporation. The Scottsdale Renaissance also invested in Eco-Lab's Formula-1 laundry control system that reduces rinse and flush cycles, lowering water use by 11% as well as programs of conservation such as encouraging guests to reuse linens and towels during their stay. In the past year, all guest rooms at The Scottsdale Renaissance have been fitted with new low-flow shower heads that reduce use of hot water by 10%.

Finally, both The Camelback Inn and The Scottsdale Renaissance conserve water pursuant to Marriott's guide for best practices that mandates a specific energy conservation program, including conservation of water.

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 threshold amount, 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.

IV. CONCLUSION

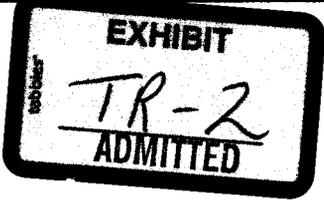
Q. WOULD PLEASE SUMMARIZE YOUR DIRECT TESTIMONY?

A. Yes. Approval of the Settlement Agreement will mitigate the deleterious financial impact to the Resorts resulting from the various surcharges implemented by AAWC under Decision No. 68858. I have attempted to show why the HUS, penalizes the Resorts for water use despite the Resorts best efforts to conserve water thereby failing to achieve the intended conservation goals. Based upon the Resorts conservation efforts, including replacing high water use plants and grass with desert 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 DIRECT TESTIMONY?

Yes it does.



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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

Direct Testimony of

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

March 28, 2008

Direct Testimony of John S. Thornton, the "Resort"
Docket Nos. W-01303A-05-0405; W-01303A-05-0910

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Table of Contents

I. Witness Identification.....1
II. Purpose of Testimony2
III. Recommendations.....3
IV. Decision No. 68858 and its Rate Effect on the Resorts.....3
V. Competitive Issues.....9
VI. Conclusion.....11

1
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I. Witness Identification

Q. WHAT IS YOUR NAME, EMPLOYER AND OCCUPATION?

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

Q. PLEASE DESCRIBE YOUR WORK EXPERIENCE AND EDUCATIONAL BACKGROUND.

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

I now consult independently for investors and consumers on utility matters. My 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

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

Q. ARE YOU SPONSORING ANY EXHIBITS?

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

III. Recommendations

Q. WHAT DO YOU RECOMMEND IN THIS CASE?

A. I recommend that the Commission amend Decision No. 68858 by adopting the Settlement Agreement. The Settlement Agreement resulted from months of work and incorporates the viewpoints and concerns of numerous stakeholders expressed throughout the negotiation process. The Settlement Agreement generally 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 contributions-in-aid-of-construction ("CIAC")-based surcharge. The PSS would initially be eliminated and AAWC would file surcharge requests similar to its arsenic cost recovery mechanism filings ("ACRM") as new fire flow improvement projects became used and useful. The new PSS would apply to the same commodity portion of rates as it does currently.

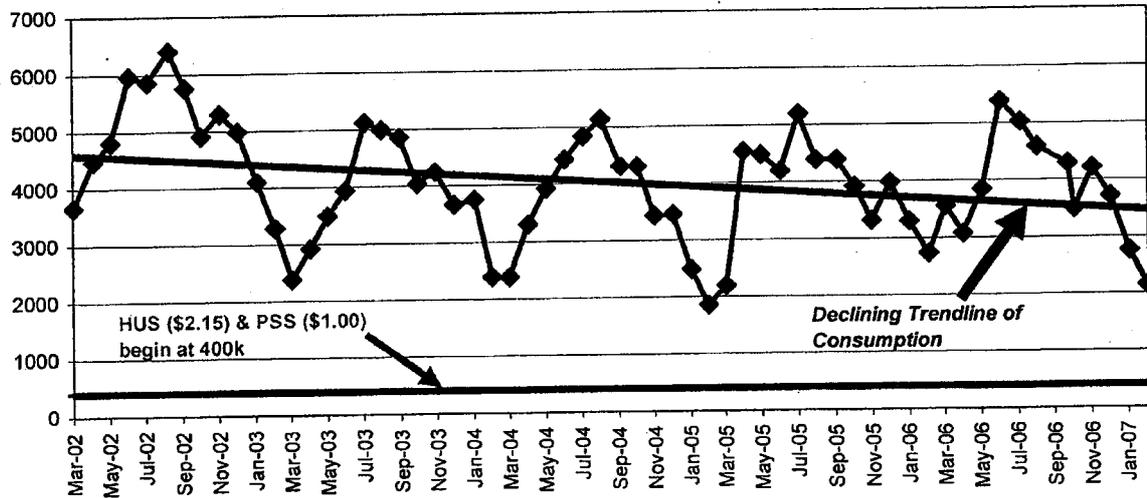
IV. Decision No. 68858 and its Rate Effect on the Resorts

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

A. 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

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

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

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.

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:

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

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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.
17
18

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

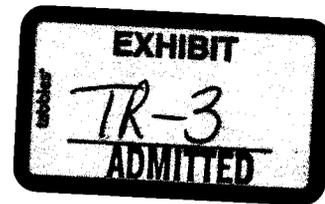
5
6 **VI. Conclusion**

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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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**

Table of Contents

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26

I. WITNESS IDENTIFICATION	1
II. PURPOSE OF TESTIMONY	1
III. REBUTTAL TO RUCO'S TESTIMONY	1
IV. REBUTTAL TO STAFF'S TESTIMONY	8
THE ORIGINAL NOTICE	9
AAWC'S BRIAN BIESEMEYER NOTICE	10
V. CONCLUSION.....	11

1
2
3
4
5
6
7
8
9
10
11
12
13
14
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19
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I. Witness Identification

Q. WHAT IS YOUR NAME, EMPLOYER AND OCCUPATION?

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

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

A. Yes, I am.

II. Purpose of Testimony

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

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

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

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

III. Rebuttal to RUCO'S Testimony

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

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

16 A. An adjustor mechanism is valuable in this context because the fire flow upgrade
17 expenditures could eventually be larger than the system’s current rate base (\$14,351,471 in
18 Decision No. 68858). Traditional recovery through multiple rate cases is administratively
19 burdensome and in any event the regulatory lag problem could be serious given the large dollar
20 amounts involved. The lag problem might be large enough to discourage Arizona-American
21 Water Company (“AAWC” or “Company”) from making large lumpy investments in its system.
22 Adjustor mechanisms should generally reduce the number of rate cases. Also, fire flow
23 investment is probably best described as revenue neutral so by adding it to rates we are not
24 committing the rate-making error of neglecting to add any associated revenues. Third, the current
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 [S/C] 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 **Q. THE RUCO WITNESS TESTIFIES ON PAGE 12 AT LINES 1 TO 4 THAT**
21 **"...THE RATE DESIGN AGREEMENT PROPOSES THAT, IN THE COMPANY'S**
22 **NEXT RATE CASE, [CIAC PROCEEDS FROM THE HBS] WOULD BE TREATED AS**
23 **INVESTMENT THAT WOULD EARN A RETURN." IS RUCO CORRECT?**
24
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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BEFORE THE ARIZONA CORPORATION COMMISSION

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- MIKE GLEASON
CHAIRMAN
- WILLIAM A. MUNDELL
COMMISSIONER
- JEFF HATCH-MILLER
COMMISSIONER
- KRISTIN K. MAYES
COMMISSIONER
- GARY PIERCE
COMMISSIONER

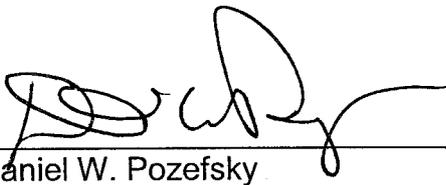
Docket No. W-01303A-05-0405

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.

NOTICE OF FILING

The Residential Utility Consumer Office ("RUCO") hereby provides notice of filing the Direct Settlement Testimony of William A. Rigsby, in the above-referenced matter.

RESPECTFULLY SUBMITTED this 24th day of April 2008


 Daniel W. Pozefsky
 Attorney

1 AN ORIGINAL AND THIRTEEN COPIES
2 of the foregoing filed this 24th day
3 of April 2008 with:

3 Docket Control
4 Arizona Corporation Commission
5 1200 West Washington
6 Phoenix, Arizona 85007

5 COPIES of the foregoing hand delivered/
6 mailed this 24th day of April 2008 to:

7 Teena Wolfe
8 Administrative Law Judge
9 Hearing Division
10 Arizona Corporation Commission
11 1200 West Washington
12 Phoenix, Arizona 85007

10 Christopher Kempley, Chief Counsel
11 Legal Division
12 Arizona Corporation Commission
13 1200 West Washington
14 Phoenix, Arizona 85007

13 Ernest Johnson, Director
14 Utilities Division
15 Arizona Corporation Commission
16 1200 West Washington
17 Phoenix, Arizona 85007

16 Paul M. Li
17 Arizona-American Water
18 19820 N. 7th Street, Suite 201
19 Phoenix, Arizona 85024

19 Craig A. Marks, Attorney At Law
20 Craig A. Marks, PLC
21 3420 E. Shea Blvd., Suite 200
22 Phoenix, Arizona 85028

21 Robert J. Metli
22 Snell & Wilmer L.L.P.
23 One Arizona Center
24 400 E. Van Buren
Phoenix, AZ 85004-2202

Timothy J. Casey
Schmitt, Schneck, Smyth & Herrod PC
1221 E. Osborne Road, Suite 105
Phoenix, Arizona 85014

By 
Ernestine Gamble

**ARIZONA AMERICAN WATER COMPANY, INC
(PARADISE VALLEY WATER DISTRICT)**

DOCKET NO. W-01303A-05-0405

**DIRECT TESTIMONY
OF
WILLIAM A. RIGSBY, CRRA**

**ON BEHALF OF
THE
RESIDENTIAL UTILITY CONSUMER OFFICE**

APRIL 24, 2008

TABLE OF CONTENTS

1		
2	INTRODUCTION.....	1
3	BACKGROUND	3
4	DISCUSSION OF THE AGREEMENT	5
5	RECOMMENDATIONS	13
6	APPENDIX 1	

1 **INTRODUCTION**

2 Q. Please state your name, occupation, and business address.

3 A. My Name is William A. Rigsby. I am a Public Utilities Analyst V employed
4 by the Residential Utility Consumer Office ("RUCO") located at 1110 W.
5 Washington, Suite 220, Phoenix, Arizona 85007.

6

7 Q. Please describe your qualifications in the field of utility regulation and your
8 educational background.

9 A. I have been involved with utility regulation in Arizona since 1994. During
10 that period of time I have worked as a utilities rate analyst for both the
11 Arizona Corporation Commission ("ACC" or "Commission") and for RUCO.
12 I hold a Bachelor of Science degree in the field of finance from Arizona
13 State University and a Master of Business Administration degree, with an
14 emphasis in accounting, from the University of Phoenix. I have also been
15 awarded the professional designation, Certified Rate of Return Analyst
16 ("CRRRA") by the Society of Utility and Regulatory Financial Analysts
17 ("SURFA"). The CRRRA designation is awarded based upon experience
18 and the successful completion of a written examination. Appendix I, which
19 is attached to this testimony, further describes my educational background
20 and also includes a list of the rate cases and regulatory matters that I have
21 been involved with.

22

23 ...

1 Q. What is the purpose of your testimony?

2 A. The purpose of my testimony is to present RUCO's position on a rate
3 design agreement ("Rate Design Agreement") that was filed with the ACC
4 on January 15, 2008. The Rate Design Agreement was reached by
5 Arizona-American Water Company, Inc. ("Arizona-American" or
6 "Company"), and signed by the Town of Paradise Valley, Sanctuary on
7 Camelback Mountain, Camelback Inn, Scottsdale Renaissance,
8 Camelhead Estates II Home Owners Association, Clearwater Hills
9 Improvement Association and Finisterre Home Owners Association
10 (hereinafter referred to as the "Parties"). Neither Arizona-American nor
11 RUCO are signatories to the Rate Design Agreement. The purpose of the
12 Rate Design Agreement is represented by the Parties as a mitigation of
13 the effects of rate shock that has been experienced by a number of
14 Arizona-American's Paradise Valley District's residential and resort
15 customers since the implementation of the rate design that was ordered in
16 Decision No. 68858, dated November 14, 2005.

17

18 Q. Does RUCO support of the Rate Design Agreement?

19 A. No. For the reasons that will be explained in my testimony, RUCO is
20 opposed to the Rate Design Agreement that is now before the
21 Commission.

22

23 ...

1 Q. Have you filed any prior testimony in this docket on behalf of RUCO?

2 A. Yes. I filed both direct and surebuttal testimony on behalf of RUCO during
3 the Arizona-American Paradise Valley District rate case proceeding which
4 resulted in Decision No. 68858. I have also been present for discussions
5 that have taken place between RUCO and Paradise Valley District
6 residential customers and the representatives for the aforementioned
7 resorts who are dissatisfied with the rate design that is presently in effect.

8

9 Q. How is your testimony organized?

10 A. My testimony is organized into four sections. First, the introduction that I
11 have just presented and second, a brief background on the events that led
12 up to the filing of the Rate Design Agreement that is now before the
13 Commission. Third, I will provide a discussion of the Rate Design
14 Agreement and why RUCO opposes it. Finally I will present RUCO's final
15 recommendation on the Rate Design Agreement and how RUCO believes
16 the current rate design issues should be resolved.

17

18 **BACKGROUND**

19 Q. Please provide a brief summary of the events that occurred prior to the
20 filing of the Agreement that is now before the Commission.

21 A. On July 3, 2005, Arizona-American, a wholly owned subsidiary of RWE
22 AG, filed an application with the ACC requesting approval of a
23 determination of the current fair value of the Company's utility plant and for

1 increases in rates and charges for customers receiving water service from
2 Arizona-American's Paradise Valley Water District. During the test year
3 ended December 31, 2004, Arizona-American provided water service to
4 an average of 4,717 Paradise Valley customers of which approximately
5 4,411, or 93.5 percent, were residential customers.

6 In addition to an increase in revenues, Arizona-American also sought
7 approval for surcharges on both an arsenic cost recovery mechanism
8 ("ACRM") and a public safety surcharge ("PSS") mechanism. The ACRM
9 surcharge would allow the Company to recover costs associated with
10 meeting the U.S. Environmental Protection Agency's revised arsenic
11 standard of 10 parts per billion. The PSS would allow Arizona-American
12 to recover all capital related costs for \$16 million in post-test year fire flow
13 improvements that were scheduled to be completed before the Company's
14 next scheduled general rate case in 2010. Arizona-American also sought
15 a high usage surcharge ("HUS") for the purpose of promoting conservation
16 in the Paradise Valley District.

17 RUCO was granted intervenor status in the proceeding and filed written
18 testimony prior to the evidentiary hearing on the Company's rate increase
19 request.

20 The evidentiary hearing on the matter was conducted from March 27 2006
21 through April 3, 2006. On Tuesday, July 25, 2006, the Commission
22 adopted, by a vote of 4 to 1, Decision No. 68858. The Decision ordered
23 the implementation of the aforementioned ACRM surcharge (at a future

1 date after the filing of required documents and schedules by the
2 Company) and an ACC Staff modified version of Arizona-American's
3 proposed rate design that included the PSS and HUS.

4 Shortly after the passage of Decision No. 68858, both the ACC and RUCO
5 began receiving complaints from Paradise Valley District Customers who
6 were experiencing rate shock as a result of the HUS which was used to
7 fund fire flow improvements (the PSS did not go into effect until October
8 2007).

9 After a number of filings which requested the Commission to reconsider
10 Decision No. 68858¹, the Commission voted to reconsider the Decision for
11 the limited purpose of reviewing the Rate Design Agreement at a noticed
12 ACC Staff meeting held on February 27, 2008.

13
14 **DISCUSSION OF THE AGREEMENT**

15 Q. Have you read the Rate Design Agreement that was filed with the
16 Commission on January 15, 2008?

17 A. Yes, I have.

18
19 Q. Please discuss the Rate Design Agreement.

20 A. The Rate Design Agreement seeks the following:
21
22

¹ RUCO did not join in the request to reconsider the Decision.

- 1 1) A reduction of the existing HUS from \$2.15 to \$1.00 per 1,000
2 gallons of water sold effective March 1, 2008. The reduced HUS
3 would recover all un-recovered fire flow improvement costs incurred
4 up to the end of February 2008 and would continue to be booked
5 by the Company as CIAC.
6
- 7 2) On March 1, 2008 the existing \$1.00 per 1,000 gallons of water
8 sold PSS would be reset to \$0.00 and would subsequently be
9 replaced with an ACRM-like mechanism that would allow for regular
10 step increases to recover the costs associated with new fire flow
11 plant at the Commission approved 10.40 percent cost of equity.
12
- 13 3) The PSS would continue to apply only to the commodity portion of
14 the rate and the first step increase filing would likely occur in the
15 later part of 2008 after Phase 3 of the fire flow project is completed.
16 A charge of \$0.125 per 1,000 gallons of water is estimated for the
17 first step increase under the proposed ACRM-like mechanism.
18
- 19 4) For fire flow plant construction phases completed after March 1,
20 2008, the PSS would be designed to recover fifty percent of the
21 investment in the improvements. The revised HUS would cover the
22 remaining fifty percent at least until a final order is issued by the

1 ACC in Arizona-American's next rate case proceeding before the
2 Commission.

3

4 5) All other rate design features of the HUS and PSS and accounting
5 deferrals would remain in their present form until a final order is
6 issued by the ACC in Arizona-American's next rate case
7 proceeding.

8

9 6) During Arizona-American's next rate case proceeding, the
10 Company will request that the proceeds from the HUS be no longer
11 treated as CIAC, and instead be treated as an investment in plant
12 in service that would provide the Company with a return on
13 investment and be fully recoverable in rates.

14

15 7) The Rate Design Agreement provides a timetable for the
16 completion of Phases 3 through 7 of the fire flow improvements, but
17 has no cost estimates for Phases 5 through 7.

18

19 Q. What is RUCO's position on the Rate Design Agreement?

20 A. RUCO is opposed to the Rate Design Agreement. While RUCO
21 recognizes that the Commission has authorized the recovery of the costs
22 of fire flow improvements over RUCO's previously-expressed objections,
23 our opposition to the Rate Design Agreement is not an attempt to undercut

1 the ACC's decision to permit the recovery of fire flow costs. Rather our
2 objection, in part is to the use of an extraordinary devise (i.e. an adjustor
3 mechanism) to recover these costs. In addition, RUCO objects to the
4 Rate Design Agreement because it would shift the recovery of costs away
5 from high use customers – contrary to the conservation goals of the
6 current rate design.

7
8 Q. What aspects of the Rate Design Agreement is RUCO concerned with?

9 A. RUCO is concerned with several of the proposals in the Rate Design
10 Agreement. RUCO's principal objection concerns the ACRM-like
11 mechanism that is being proposed.

12
13 Q. Why is RUCO opposed to the use of an ACRM-like mechanism to recover
14 fire flow costs?

15 A. There are several reasons why RUCO is opposed to the ACRM-like
16 mechanism. Adjustor mechanisms are extraordinary rate recovery
17 devices that are permitted for certain narrow circumstances. The ACRM
18 is a type of adjustor mechanism that was specifically designed to address
19 a one-time event that impacted dozens of Arizona water companies
20 simultaneously. The Company's expenditures for fire flow are not the type
21 of expense for which an adjustor mechanism is generally permitted, nor
22 are they similar to the costs recovered through the ACRM.

1 The original ACRM was approved by the Commission to give water
2 providers in Arizona the ability to recover the costs associated with
3 meeting the U.S. Environmental Protection Agency's ("EPA") revised
4 drinking water arsenic standard of 10 parts per billion. The EPA's
5 requirement that water providers comply with the more stringent standard
6 was in effect an unfunded mandate from the federal government. Multiple
7 Arizona water providers had no choice but to either comply with the EPA's
8 rule or face the consequences of being in violation of it. This being the
9 case, representatives from the state's investor owned water companies,
10 ACC Staff, and RUCO developed the present ACRM which allows water
11 utilities to comply with the new EPA standard through a surcharge that
12 was established within the context of a rate case proceeding where a
13 constitutional finding of a utility's fair value has been established. The key
14 point here is that the EPA's revised arsenic standard represented an
15 extraordinary circumstance that neither Arizona's government, which
16 includes the Commission, or the state's water companies, either investor
17 owned or municipal, had any control over, and that would be impacting a
18 number of water utilities simultaneously.

19 Under the Rate Design Agreement, Arizona-American can seek step
20 increases to fund future construction phases that have no definite cost
21 estimates at this time. By approving the Rate Case Agreement with its
22 ACRM-like mechanism that allows for an unspecified number of step

1 increases, the Commission may well be handing a blank check to the
2 Company.

3

4 Q. Are there any similar mandates in regard to the fire flow improvements?

5 A. No. There is no federal, or for that matter any other, mandates requiring
6 that Arizona-American be required to construct the fire flow improvements
7 that Paradise Valley District ratepayers are now funding through the HUS
8 and PSS. Nor are there any other extraordinary circumstances that would
9 warrant the approval of an ACRM-like mechanism in this case. As I stated
10 earlier, the Company was and, to the best of my knowledge, still is in
11 compliance with the ACC's rules regarding fire protection. In this
12 proceeding, the Town of Paradise Valley desired fire flow improvements
13 which exceeded the ACC's requirements that the Company was in
14 compliance with. Because Arizona-American is in compliance with
15 existing Commission fire flow rules, the expenditures required for the fire
16 flow improvements are therefore discretionary in nature.

17

18 Q. Are there other ways in which the proposed ACRM-like mechanism is
19 different than the original ACRM?

20 A. Yes. The ACRMs that the Commission has approved have been for
21 projects that had definite cost estimates, but the Company has no definite
22 cost estimates for future phases of the fire flow project. Further, the
23 ACRMs that have been approved have all permitted only a fixed number

1 of step increases. The proposed ACRM-like mechanism would allow for
2 an unspecified number of step increases. By approving the proposed
3 mechanism, the Commission may well be handing the Company a blank
4 check for fire flow improvements.

5

6 Q. Does RUCO have any other concerns regarding the Rate Design
7 Agreement?

8 A. Yes, the proposed Rate Design Agreement will harm the residential class
9 of ratepayers by shifting the recovery of fire flow costs from high-end
10 users to low-end users. The PSS currently is collected in proportion to
11 commodity usage. Under the proposed Rate Design Agreement, the
12 costs for the fire flow improvements would be recovered from all of the
13 Company's customers as opposed to only high-end users. This would
14 discourage conservation which was one of the chief features of the
15 present rate design.

16 The new rate design would also spread the cost to many ratepayers who
17 are not affected under the current rate design. The use of an ACRM-like
18 mechanism is inappropriate and would shift costs from the resorts to
19 ratepayers who are currently unaffected by the current rate design.

20

21

22 ...

1 Q. Currently, the HUS proceeds are treated as contributions in aid-of-
2 construction ("CIAC"), but the Rate Design Agreement proposes that, in
3 the Company's next rate case, those proceeds would be treated as
4 investment that would earn a return. What is your reaction to that aspect
5 of the proposal?

6 A. It is appropriate to treat the proceeds of the HUS as CIAC, because they
7 are non-investor-supplied funds for the specific purpose of funding the fire
8 flow plant. Since these funds are not being provided by Arizona-
9 American's investors, it would be patently unfair for the Company to earn
10 a rate of return on them. The Commission should reject the Rate Design
11 Agreement's proposal to allow the Company to earn a return on HUS
12 proceeds after the next rate case.

13

14 Q. Please summarize your objections to the Rate Design Agreement.

15 A. For the reasons stated above, RUCO does not believe that Paradise
16 Valley Ratepayers will be any better off under the proposals contained in
17 the Rate Design Agreement. The advantages of the proposed surcharge
18 reductions may prove to be meaningless if the proposed ACRM-like
19 mechanism, that has a provision for no specified number of future step
20 increases, is approved. Furthermore the very fact that an ACRM-like
21 mechanism could be approved to fund a project that is clearly
22 discretionary in nature (due to the fact that Arizona-American is already in
23 compliance with the ACC' fire flow rules), harms different classes of

1 ratepayers, has no definite final cost estimates and is not required by any
2 federal or state mandates, makes the approval of the Rate Design
3 Agreement totally unacceptable in RUCO's view.
4

5 **RECOMMENDATIONS**

6 Q. What are RUCO's final recommendations?

7 A. For the reasons stated above, RUCO recommends that the Commission
8 reject the Rate Design Agreement. RUCO believes that Arizona-
9 American's upcoming rate case application, which is expected to be filed
10 sometime in either April or May 2008, is the better forum to make changes
11 to the Company's existing rate design for recovery of the fire flow costs.
12 The rate case will provide all of the concerned parties with the opportunity
13 to examine this issue with all of the other ratemaking elements that
14 determine what just and reasonable rates should be for the Company's
15 Paradise Valley District ratepayers.
16

17 Q. Does your silence on any of the issues, matters or findings addressed in
18 the testimony of any of the other witness who have testified in this docket
19 constitute your acceptance of their positions on such issues, matters or
20 findings?

21 A. No, it does not.
22
23 ...

- 1 Q. Does this conclude your testimony?
- 2 A. Yes, it does.

Qualifications of William A. Rigsby, CRRA

EDUCATION:

University of Phoenix
Master of Business Administration, Emphasis in Accounting, 1993

Arizona State University
College of Business
Bachelor of Science, Finance, 1990

Mesa Community College
Associate of Applied Science, Banking and Finance, 1986

Society of Utility and Regulatory Financial Analysts
38th Annual Financial Forum and CRRA Examination
Georgetown University Conference Center, Washington D.C.
Awarded the Certified Rate of Return Analyst designation
after successfully completing SURFA's CRRA examination.

Michigan State University
Institute of Public Utilities
N.A.R.U.C. Annual Regulatory Studies Program, 1997 & 1999

Florida State University
Center for Professional Development & Public Service
N.A.R.U.C. Annual Western Utility Rate School, 1996

EXPERIENCE:

Public Utilities Analyst V
Residential Utility Consumer Office
Phoenix, Arizona
April 2001 – Present

Senior Rate Analyst
Accounting & Rates - Financial Analysis Unit
Arizona Corporation Commission, Utilities Division
Phoenix, Arizona
July 1999 – April 2001

Senior Rate Analyst
Residential Utility Consumer Office
Phoenix, Arizona
December 1997 – July 1999

Utilities Auditor II and III
Accounting & Rates – Revenue Requirements Analysis Unit
Arizona Corporation Commission, Utilities Division
Phoenix, Arizona
October 1994 – November 1997

Tax Examiner Technician I / Revenue Auditor II
Arizona Department of Revenue
Transaction Privilege / Corporate Income Tax Audit Units
Phoenix, Arizona
July 1991 – October 1994

RESUME OF RATE CASE AND REGULATORY PARTICIPATION

<u>Utility Company</u>	<u>Docket No.</u>	<u>Type of Proceeding</u>
ICR Water Users Association	U-2824-94-389	Original CC&N
Rincon Water Company	U-1723-95-122	Rate Increase
Ash Fork Development Association, Inc.	E-1004-95-124	Rate Increase
Parker Lakeview Estates Homeowners Association, Inc.	U-1853-95-328	Rate Increase
Mirabell Water Company, Inc.	U-2368-95-449	Rate Increase
Bonita Creek Land and Homeowner's Association	U-2195-95-494	Rate Increase
Pineview Land & Water Company	U-1676-96-161	Rate Increase
Pineview Land & Water Company	U-1676-96-352	Financing
Montezuma Estates Property Owners Association	U-2064-96-465	Rate Increase
Houghland Water Company	U-2338-96-603 et al	Rate Increase
Sunrise Vistas Utilities Company – Water Division	U-2625-97-074	Rate Increase
Sunrise Vistas Utilities Company – Sewer Division	U-2625-97-075	Rate Increase
Holiday Enterprises, Inc. dba Holiday Water Company	U-1896-97-302	Rate Increase
Gardener Water Company	U-2373-97-499	Rate Increase
Cienega Water Company	W-2034-97-473	Rate Increase
Rincon Water Company	W-1723-97-414	Financing/Auth. To Issue Stock
Vail Water Company	W-01651A-97-0539 et al	Rate Increase
Bermuda Water Company, Inc.	W-01812A-98-0390	Rate Increase
Bella Vista Water Company	W-02465A-98-0458	Rate Increase
Pima Utility Company	SW-02199A-98-0578	Rate Increase

RESUME OF RATE CASE AND REGULATORY PARTICIPATION (Cont.)

<u>Utility Company</u>	<u>Docket No.</u>	<u>Type of Proceeding</u>
Pineview Water Company	W-01676A-99-0261	WIFA Financing
I.M. Water Company, Inc.	W-02191A-99-0415	Financing
Marana Water Service, Inc.	W-01493A-99-0398	WIFA Financing
Tonto Hills Utility Company	W-02483A-99-0558	WIFA Financing
New Life Trust, Inc. dba Dateland Utilities	W-03537A-99-0530	Financing
GTE California, Inc.	T-01954B-99-0511	Sale of Assets
Citizens Utilities Rural Company, Inc.	T-01846B-99-0511	Sale of Assets
MCO Properties, Inc.	W-02113A-00-0233	Reorganization
American States Water Company	W-02113A-00-0233	Reorganization
Arizona-American Water Company	W-01303A-00-0327	Financing
Arizona Electric Power Cooperative	E-01773A-00-0227	Financing
360networks (USA) Inc.	T-03777A-00-0575	Financing
Beardsley Water Company, Inc.	W-02074A-00-0482	WIFA Financing
Mirabell Water Company	W-02368A-00-0461	WIFA Financing
Rio Verde Utilities, Inc.	WS-02156A-00-0321 et al	Rate Increase/ Financing
Arizona Water Company	W-01445A-00-0749	Financing
Loma Linda Estates, Inc.	W-02211A-00-0975	Rate Increase
Arizona Water Company	W-01445A-00-0962	Rate Increase/ACRM
Mountain Pass Utility Company	SW-03841A-01-0166	Financing
Picacho Sewer Company	SW-03709A-01-0165	Financing
Picacho Water Company	W-03528A-01-0169	Financing
Ridgeview Utility Company	W-03861A-01-0167	Financing
Green Valley Water Company	W-02025A-01-0559	Rate Increase
Bella Vista Water Company	W-02465A-01-0776	Rate Increase
Arizona Water Company	W-01445A-02-0619	Rate Increase/ACRM

RESUME OF RATE CASE AND REGULATORY PARTICIPATION (Cont.)

<u>Utility Company</u>	<u>Docket No.</u>	<u>Type of Proceeding</u>
Arizona-American Water Company	W-01303A-02-0867 et al.	Rate Increase
Arizona Public Service Company	E-01345A-03-0437	Rate Increase
Rio Rico Utilities, Inc.	WS-02676A-03-0434	Rate Increase
Qwest Corporation	T-01051B-03-0454	Renewed Price Cap
Chaparral City Water Company	W-02113A-04-0616	Rate Increase
Arizona Water Company	W-01445A-04-0650	Rate Increase/ACRM
Tucson Electric Power	E-01933A-04-0408	Rate Review
Southwest Gas Corporation	G-01551A-04-0876	Rate Increase
Arizona-American Water Company	W-01303A-05-0405	Rate Increase/ACRM
Black Mountain Sewer Corporation	SW-02361A-05-0657	Rate Increase
Far West Water & Sewer Company	WS-03478A-05-0801	Rate Increase
Gold Canyon Sewer Company	SW-02519A-06-0015	Rate Increase
Arizona Public Service Company	E-01345A-05-0816	Rate Increase
Arizona-American Water Company	W-01303A-06-0014	Rate Increase
Arizona-American Water Company	W-01303A-05-0718	Transaction Approval
UNS Gas, Inc.	G-04204A-06-0463	Rate Increase
Arizona-American Water Company	WS-01303A-06-0403	Rate Increase
Arizona-American Water Company	WS-01303A-06-0491	Rate Increase
UNS Electric, Inc.	E-04204A-06-0783	Rate Increase
Arizona-American Water Company	W-01303A-07-0209	Rate Increase
Tucson Electric Power	E-01933A-07-0402	Rate Increase
Southwest Gas Corporation	G-01551A-07-0504	Rate Increase



BEFORE THE ARIZONA CORPORATION COMMISSION

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- MIKE GLEASON
CHAIRMAN
- WILLIAM A. MUNDELL
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- KRISTIN K. MAYES
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- GARY PIERCE
COMMISSIONER

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 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

NOTICE OF FILING

The Residential Utility Consumer Office ("RUCO") hereby provides notice of filing the Rebuttal Testimony of William A. Rigsby, CRRA, in the above-referenced matter.

RESPECTFULLY SUBMITTED this 9th day of May 2008.



Daniel Pozefsky
Attorney

1 AN ORIGINAL AND THIRTEEN COPIES
of the foregoing filed this 9th day
2 of May 2008 with:

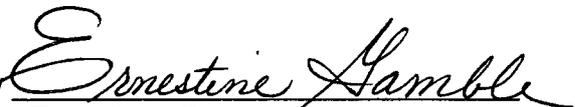
3 Docket Control
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6 mailed this 9th day of May 2008 to:

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Administrative Law Judge
8 Hearing Division
Arizona Corporation Commission
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Phoenix, Arizona 85007

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Arizona Corporation Commission
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24

**ARIZONA-AMERICAN WATER COMPANY, INC.
(PARADISE VALLEY WATER DISTRICT)**

DOCKET NO. W-01303A-05-0405

**REBUTTAL TESTIMONY
OF
WILLIAM A. RIGSBY, CRRA**

**ON BEHALF OF
THE
RESIDENTIAL UTILITY CONSUMER OFFICE**

MAY 9, 2008

TABLE OF CONTENTS

1		
2	INTRODUCTION.....	1
3	RUCO'S REBUTTAL POSITION.....	2
4	RUCO'S REBUTTAL RECOMMENDATIONS.....	3

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2 Q. Please state your name, occupation, and business address.

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Daniel Pozefsky
Attorney

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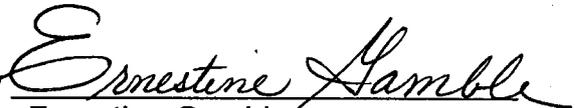
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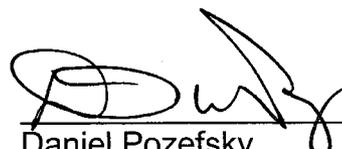
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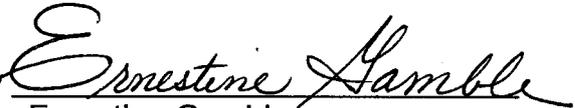
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1 **RUCO'S REBUTTAL POSITION**

2 Q. Has RUCO changed its original recommendation on the Rate Design
3 Agreement?

4 A. No. For the reasons that were discussed in my direct testimony, RUCO
5 still recommends that the Commission reject the Rate Design Agreement.

6

7 Q. Have you had an opportunity to review the direct testimony filed by other
8 parties to the case?

9 A. Yes. I have read the direct testimony of ACC Staff witness Darron W.
10 Carlson and the direct testimony of Arizona-American witness Miles H.
11 Kiger.

12

13 Q. Does RUCO have any additional recommendations based on the
14 information or recommendations presented by either Mr. Carlson or Mr.
15 Kiger?

16 A. Yes. RUCO is in support of Mr. Carlson's recommendation to provide
17 interim relief to the Paradise Valley District's residential and resort
18 customers by reducing the HUS from the current \$2.15 per 1,000 gallons
19 to \$1.00 per 1,000 gallons. RUCO also supports Mr. Carlson's
20 recommendation to eliminate the PSS until the Commission has the
21 opportunity to examine the fire flow issue in the Company's next rate case
22 proceeding.

23

1 Q. Does this mean that RUCO has changed its previous positions regarding
2 fire flow infrastructure improvements in the Paradise Valley District?

3 A. No. RUCO wants to make it perfectly clear that it has not changed its
4 previous positions regarding fire flow infrastructure improvements in the
5 Paradise Valley District. RUCO supports Mr. Carlson's recommendations
6 strictly for the purpose of providing interim rate relief for the affected
7 residential and resort customers who are currently experiencing rate
8 shock as a result of the rate design ordered in Decision No. 68858.

9

10 Q. Should the Company interpret RUCO's adoption of Mr. Carlson's
11 recommendations as a possible acceptance of an ACRM-like mechanism
12 to fund fire flow infrastructure improvements in the Paradise Valley
13 District?

14 A. No. RUCO wants to make it clear to the Company that it should not form
15 any expectations that RUCO could support an ACRM-like mechanism to
16 fund fire flow infrastructure improvements in the Paradise Valley District.

17

18 **RUCO'S REBUTTAL RECOMMENDATIONS**

19 Q. What are RUCO's final rebuttal recommendations?

20 A. RUCO recommends that the Commission adopt ACC Staff's
21 recommendation to reduce the existing HUS from the current \$2.15 per
22 1,000 gallons to \$1.00 per 1,000 gallons.

1 RUCO also recommends that the Commission adopt ACC Staff's
2 recommendation to eliminate the PSS until the Commission has the
3 opportunity to examine the fire flow issue in the Company's next rate case
4 proceeding.

5 RUCO continues to recommend that the Commission reject the Rate
6 Design Agreement. RUCO believes, as does ACC Staff, that Arizona-
7 American's upcoming Paradise Valley District rate case application (which
8 was filed on May 1, 2008) is the better forum to make changes to the
9 Company's existing rate design for recovery of the fire flow costs. The
10 rate case will provide all of the concerned parties with the opportunity to
11 examine this issue with all of the other ratemaking elements that
12 determine what just and reasonable rates should be for the Company's
13 Paradise Valley District ratepayers.

14

15 Q. Does your silence on any of the issues, matters or findings addressed in
16 the testimony of any of the witness who have testified in this docket
17 constitute your acceptance of their positions on such issues, matters or
18 findings?

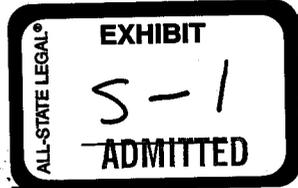
19 A. No, it does not.

20

21 Q. Does this conclude your testimony?

22 A. Yes, it does.

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BEFORE THE ARIZONA CORPORATION COMMISSION

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

DOCKET NO. W-01303A-05-0910

NOTICE OF FILING

Staff of the Arizona Corporation Commission ("Commission") hereby files the Direct
Testimony of Darron W. Carlson of the Utilities Division, in the above-referenced matter.

RESPECTFULLY SUBMITTED this 25th day of April, 2008.

Maureen A. Scott, Senior Staff Counsel
Arizona Corporation Commission
Legal Division
1200 West Washington Street
Phoenix, Arizona 85007
(602) 542-3402

Arizona Corporation Commission
DOCKETED

APR 25 2008

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1 Original and fifteen (15) copies
of the foregoing were filed this
2 25th day of April, 2008 with:

3 Docket Control
Arizona Corporation Commission
4 1200 West Washington Street
Phoenix, Arizona 85007

5
6 Copies of the foregoing mailed this
25th day of April, 2008 to:

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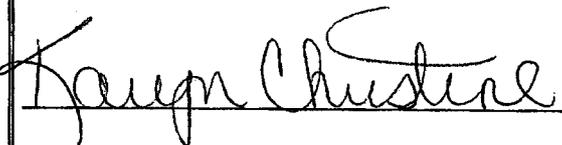
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DIRECT

TESTIMONY

OF

DARRON W. CARLSON

**DOCKET NOS. W-01303A-05-0405 AND
W-01303A-05-0910**

**IN THE MATTER OF THE APPLICATIONS 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 CHARGES BASED
THEREON FOR UTILITY SERVICE BY ITS
PARADISE VALLEY WATER DISTRICT AND
FOR APPROVAL OF AN AGREEMENT WITH
THE PARADISE VALLEY COUNTRY CLUB**

APRIL 25, 2008

BEFORE THE ARIZONA CORPORATION COMMISSION

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

IN THE MATTER OF THE APPLICATIONS 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 CHARGES BASED)
THEREON FOR UTILITY SERVICE BY ITS)
PARADISE VALLEY WATER DISTRICT AND)
FOR APPROVAL OF AN AGREEMENT WITH)
THE PARADISE VALLEY COUNTRY CLUB)
_____)

DOCKET NOS. W-01303A-05-0405
W-01303A-05-0910

RECONSIDERATION OF
DECISION NO. 68858 PURSUANT
TO A.R.S. § 40-252 FOR THE
LIMITED PURPOSE OF
REVIEWING THE RATE DESIGN
AGREEMENT

DIRECT

TESTIMONY

OF

DARRON W. CARLSON

PUBLIC UTILITIES ANALYST MANAGER

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

APRIL 25, 2008

TABLE OF CONTENTS

	<u>Page</u>
INTRODUCTION	1
BACKGROUND	2
AGREEMENT	3
RECOMMENDATIONS	11

EXECUTIVE SUMMARY
ARIZONA-AMERICAN WATER COMPANY, INC., -
PARADISE VALLEY WATER DISTRICT
DOCKET NOS. W-01303A-05-0405 AND W-01303A-05-0910

Arizona-American Water Company, Inc., - Paradise Valley Water District ("PVWD" or "Company") is a Class A water utility. PVWD serves approximately 4,725 residential customers and 25 commercial customers in portions of the Town of Paradise Valley, City of Scottsdale, and unincorporated Maricopa County.

This case arises from the Commission's Decision No. 68858 issued on July 28, 2006, in PVWD's last rate case, Docket No. W-01303A-05-0405. Subsequent to that date, concerns were raised by the Town of Paradise Valley ("Town"), several resorts and Paradise Valley residents regarding the combined impact of the various surcharges. As a result, the Town indicates that there have been numerous discussions, meetings, and filings regarding the following two surcharges: 1) the High Block Usage Surcharge and 2) the Public Safety Surcharge. On January 16, 2008, the Town submitted a proposed Rate Design Agreement ("Agreement"). Other signatories to the Agreement included the Camelback Inn, Sanctuary on Camelback Mountain, Renaissance Scottsdale Resorts, Camelhead 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 Agreement. The Agreement requests that the Commission reduce the High Block Surcharge 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 Public Safety Surcharge which is set at \$1.00 per 1,000 gallons of usage. Additionally, the Agreement requests that a new Public Safety Surcharge be implemented in the future in Arsenic Cost Recovery Mechanism ("ACRM") step like fashion. The Agreement also requests changing the accounting treatment of funds received from the Public Safety Surcharge after March 1, 2008, from "contributions" to "revenues".

If the Commission desires to give the Petitioning Parties some interim relief until PVWD's next rate case, Staff recommends, that the Commission grant the Petitioning Parties' request to reduce the High Block Usage Surcharge to \$1.00 per 1,000 gallons of usage. Staff also recommends that the Commission grant the Petitioning Parties' request to eliminate the current Public Safety Surcharge.

However, Staff recommends, that at this time, the Commission deny the Petitioning Parties' requests to implement a future Public Safety Surcharge in ACRM step like fashion and to account for the funds as "revenues" rather than "contributions". The Company has stated that it will be filing a new rate case for PVWD in the next month, and Staff believes that it is more appropriate to examine future surcharges and their accounting treatment in that case.

1 **INTRODUCTION**

2 **Q. Please state your name, occupation, and business address.**

3 A. My name is Darron W. Carlson. I am a Public Utilities Analyst Manager employed by the
4 Arizona Corporation Commission ("ACC" or "Commission") in the Utilities Division
5 ("Staff"). My business address is 1200 West Washington Street, Phoenix, Arizona 85007.
6

7 **Q. Briefly describe your responsibilities as a Public Utilities Analyst Manager.**

8 A. In my capacity as a Public Utilities Analyst Manager, I supervise analysts who examine,
9 verify, and analyze utilities' statistical, financial, and other information. These analysts
10 write reports and/or testimonies analyzing proposed mergers, acquisitions, asset sales,
11 financings, rate cases, and other matters in which they make recommendations to the
12 Commission. I provide support and guidance along with reviewing and editing the work
13 products. I also perform analysis as needed on special projects. Additionally, I provide
14 expert testimony at formal hearings. Finally, I assist Staff members during formal
15 hearings and supervise responsive testimonies, as needed during the hearing process.
16

17 **Q. Please describe your educational background and professional experience.**

18 A. I hold Bachelor of Arts degrees in both Accounting and Business Management from
19 Northeastern Illinois University in Chicago, Illinois. I have participated in many seminars
20 and workshops related to utility rate-making, cost of capital, and similar issues. These
21 seminars have been sponsored the National Association of Regulatory Utility
22 Commissioners ("NARUC"), Duke University, Florida State University, Michigan State
23 University, New Mexico State University, and various other organizations. I have led or
24 actively participated in more than 125 cases before this Commission over the last
25 seventeen years. Since my promotion to management, I have supervised analysts involved
26 in more than 150 additional cases before this Commission.

1 **Q. What is the scope of your testimony in this case?**

2 A. I am presenting Staff's analysis regarding the proposed Rate Design Agreement
3 ("Agreement") that was originally filed by the Town of Paradise Valley ("Town") on
4 January 16, 2008.

5
6 **Q. Are other members of Staff presenting testimony in this proceeding?**

7 A. No.
8

9 **BACKGROUND**

10 **Q. What is the purpose of this proceeding?**

11 A. This proceeding was a result of the Commission's decision to reconsider, pursuant to
12 A.R.S. §40-252, the rate design approved by the Commission in Decision No. 68858, the
13 last PVWD rate case. Decision No. 68858 was issued on July 28, 2006. On September
14 28, 2007, the Town submitted to the Commission, Town Resolution No. 1156 that
15 requested reconsideration of the "High Block" and "Public Safety" Surcharges for the
16 Arizona-American Water Company ("Arizona-American") Paradise Valley Water District
17 ("PVWD") approved in Commission Decision No. 68858. Since that time, the Town has
18 had numerous meetings with Town residents (including some of the larger homeowners'
19 associations) and the resorts within the Town affected by the Decision to see if a
20 consensus rate design could be negotiated among these groups. On January 6, 2008, the
21 Petitioning Parties filed the Agreement with the Commission and requested
22 reconsideration of Decision No. 68858.

23

24 After the Commission decided to reconsider the PVWD rate design, on March 14, 2008, a
25 Procedural Order was issued requiring the Petitioning Parties to file Direct Testimony

1 regarding the Agreement on March 28, 2008, and requiring Responsive Testimony on
2 April 25, 2008. On March 28, 2008, the Resorts and the Town filed Direct Testimony.
3

4 **AGREEMENT**

5 **Q. Who or what parties participated in creating the Agreement filed by the Town?**

6 A. Along with the Town, group participants and Petitioning Parties included the Camelback
7 Inn, Sanctuary on Camelback Mountain, and the Renaissance Scottsdale Resort,
8 collectively the "Resorts"; also Camelhead Estates II Home Owner's Association
9 ("HOA"), Clearwater Hills Improvement Association, and Finisterre HOA. All of the
10 aforementioned were signatories to the Agreement. Although PVWD participated in the
11 creation of it, PVWD did not sign the Agreement.
12

13 **Q. What events led to the Agreement?**

14 A. Town Witness Mary Hamway, an elected member of the Town's Council, stated that
15 Town officials received complaints from frustrated residents who were surprised by the
16 impact of the first Surcharge. She stated that the Agreement rectifies in part: 1) the
17 unintended consequences of placing the resorts within the Town at a competitive
18 disadvantage when compared to resorts that are not within the Arizona-American Paradise
19 Valley Service Area; and 2) the significant and unexpected rate increases incurred by
20 Town residential users.
21

22 **Q. Did the Town or Resorts participate as Intervenors in the Proceeding before the
23 Commission?**

24 A. Witness Hamway stated that the Town withdrew its Motion to Intervene because the
25 Town Council did not have a full understanding of the value of serving as an Intervenor.
26 Ms. Hamway stated that the Town should not have withdrawn its Motion to Intervene.

1 Soon after the receipt of the Commission's July 28, 2006 Decision, the Town realized
2 there were significant unintended consequences for the resorts located in Paradise Valley
3 and unexpected impacts to the residents as a result of the "High Block" Surcharge and the
4 "Public Safety" Surcharge.

5
6 The Resorts chose not to intervene.

7
8 **Q. Why Is the Town advocating the particular rate restructuring that it has proposed in**
9 **the Agreement?**

10 **A.** Town Witness Hamway stated that a review of the water charges incurred by Paradise
11 Valley resorts under Decision No. 68858 compared to the water charges of Phoenix and
12 Scottsdale resorts allowed Town officials to conclude that the resorts within the Paradise
13 Valley Water District are paying significantly more for their water than their nearby
14 competitors. This results in an increase in their room rates which places them at a
15 competitive financial disadvantage. Ms. Hamway further stated that the operational
16 success of the resorts within the Town is an essential element of the Town's economic
17 viability and sustainability.

18
19 She also stated that the proposal is fair because the "high block" non-commercial residents
20 in the PVWD perceive that the "high block" rate increase was implemented without
21 sufficient notice and inequitably requires only the "high block" users (only 20% of
22 PVWD's customer base) to pay for the bulk of the fire-flow improvements.

23
24 Finally, she states that this interim relief will allow the Town further time to review,
25 discuss, and implement meaningful water conservation measures intended to strongly
26 encourage "high block" residential customers to conserve water.

1 **Q. What lead to the initial rate design adopted in Decision No. 66858?**

2 A. Staff notes that these surcharges were created to address two issues that PVWD was
3 experiencing at the time of the instant rate case. The Public Safety Surcharge was created
4 to help PVWD fund the expensive fire flow projects the Town sought to put in place.
5 PVWD had stated that with the Public Safety Surcharge, the fire flow project would be
6 delayed. For this reason, it also allowed use of the High Block Usage Surcharge to fund
7 the fire flow projects. In addition, The High Block Usage Surcharge was created to
8 encourage water conservation in the high-use PVWD by transferring more costs to the
9 high users in the system. The Commission, in Decision No. 68858, allowed use of the
10 High Block Usage Surcharge for the period of construction of the fire flow projects only.
11 It also ordered the automatic end to the Public Safety Surcharge once the fire flow projects
12 were completed. The funds from the High Block Usage Surcharge were then to be used to
13 fund other PVWD projects.

14
15 **Q. Please explain what or how the Agreement would alter Decision No. 68858.**

16 A. The Agreement provides for a reduction of the High Block Usage Surcharge from its
17 current \$2.15 per 1,000 gallons of usage to \$1.00 per 1,000 gallons of usage, and to
18 continue to account for the proceeds as Contributions in Aid of Construction ("CIAC"). It
19 would recover all unrecovered fire-flow costs incurred as of February 29, 2008, if any,
20 including Commission authorized accounting costs deferrals.

21
22 Further, the Agreement requests the elimination of the current Public Safety Surcharge
23 which is \$1.00 per 1,000 gallons of usage. The Agreement further proposes that the
24 Public Safety Surcharge be reestablished in the future in a step-like fashion similar to an
25 Arsenic Cost Recovery Mechanism ("ACRM"). The Petitioning Parties propose that all

1 the various ACRM conditions required by the Commission in its previous orders apply as
2 well.

3
4 The Commission would use the finding of fair value in Decision No. 68858 to determine
5 fair value of subsequent step increases, as it does with the ACRM. The Public Safety
6 Surcharge would continue to apply only to the commodity portion of the rate. The first
7 step increase filing is anticipated in late 2008 upon completion of Phase 3 of Paradise
8 Valley's fire-flow project already under construction. The proposed Public Safety
9 Surcharge would recover investments made after March 1, 2008, under a revenue
10 requirements formula rather than CIAC.

11
12 For fire flow phases completed after March 1, 2008, the Public Safety Surcharge would be
13 designed to recover 50 percent of the investment. The revised High Block Surcharge
14 would recover the remaining 50 percent until a final order is effective in PVWD's next
15 rate case.

16
17 Ralph Scatena, the witness on behalf of the Resorts, testified that the Agreement includes
18 a consensus rate design which would act as an interim solution pending the next rate case.
19 He further states that it results in immediate and needed rate relief for all effected
20 ratepayers, including the Resorts.

21
22 **Q. Does the Agreement only affect the Resorts?**

23 **A.** No. While the Agreement is being sponsored or proposed by the Town and the Resorts, as
24 well as several HOAs, it also would provide relief to all high block customers, including
25 residential.

1 **Q. What is Staff's assessment in general of the results of the Agreement?**

2 A. The Petitioning Parties have obviously put a lot of time into the Agreement. Moreover, it
3 appears that they have sought to achieve consensus among the stakeholders, which was
4 important to the Commission, if reconsideration was granted.

5
6 If the Commission believes that some interim rate relief is appropriate at this time, then
7 there are portions of the Agreement that Staff would support. Further, PVWD does not
8 object to the proposed reduction in the surcharges at this time. Staff thus, in general,
9 believes the Agreement should be given serious consideration by the Commission. The
10 testimony of both the Town and Resorts raise some compelling points in favor of portions
11 of the Agreement. But the Commission should defer some of the proposals in the
12 Agreement to the Company's soon to be filed rate case.

13
14 **Q. What points did the Town and Resorts make in their testimony that Staff believe**
15 **favor some relief at this time?**

16 A. Resort witness Scatena states that the Camelback Inn's water rates have gone up
17 approximately 220%, or an additional \$220,620 per year. The Resorts believe that the
18 current High Usage Surcharge ("HUS") conservation threshold for commercial customers
19 which was set at 400,000 gallons per month, is arbitrary and unfairly penalizes the
20 Resorts. The Resorts minimum needs far exceed 400,000 gallons per month. In contrast,
21 the residential threshold was set at 80,000 gallons per month. Both of these thresholds
22 were proposed by the Company. Thus the threshold for resorts is set at the equivalent of
23 only 5 residential homes. The Camelback Inn covers 188 acres, while a typical residential
24 home in the PVWD covers one acre.

25

1 Witness Scatena also states that the second tier amount of 400,000 gallons, based upon the
2 Resorts' water usage patterns, will not promote any additional significant conservation
3 and is therefore a purely punitive charge. Moreover, the Resorts argue that they have
4 undertaken considerable conservation efforts: replacing high water use plants and grass
5 with xeriscape landscaping; upgrading and improving irrigation management systems and
6 infrastructure; minimizing water use through efficient delivery systems and prudent water
7 conservation policies; and seasonal and climactic adjustment. They also state that they
8 continue to examine ways to improve conservation.
9

10 **Q. Why shouldn't the Commission just wait to reexamine this issue when the Company**
11 **files its next rate case?**

12 A. Mr. Scatena, testified that the Resorts need the relief now and the process for litigating a
13 rate case can be in excess of one year. If an interim solution is approved, it would also be
14 most beneficial for the Resorts if the new rate design was implemented prior to the high
15 water usage summer months.
16

17 Finally, Town witness Hamway states that less revenue from Resorts, if they are
18 competitively disadvantaged, will ultimately harm the Town. She also indicates that High
19 Block Users believe they are unfairly bearing most of the fire flow expense.
20

21 **Q. Does Staff agree with all of the provisions of the proposed Agreement?**

22 A. No.

1 **Q. Does Staff agree with the proposal in the Agreement to reduce the High Block**
2 **Surcharge and eliminate the Public Safety Surcharge until the Commission's Order**
3 **in the next rate case?**

4 A. Yes. Staff agrees with these recommendations. However, this should not preclude
5 reexamination of the issues in the next rate case, to the extent desired.

6
7 **Q. If the High Block Surcharge is reduced and the Public Safety Surcharge is**
8 **eliminated, how do the Petitioning Parties propose to make up for this reduction in**
9 **the Company's revenues?**

10 A. That is not addressed in the proposed Agreement. However, the Company participated in
11 its formulation, and it is Staff's understanding that the Company is in agreement with the
12 proposed reductions. Additionally, the Company intends to immediately file another rate
13 case, wherein this issue will be looked at again.

14
15 **Q. What is Staff's assessment of the Agreement's request to alter the future funding of**
16 **fire flow phases completed after March 1, 2008?**

17 A. Staff believes that it is inappropriate to entertain these types of alterations to the prior
18 Decision at this time. Staff recommends that all issues other than the
19 reduction/elimination of surcharges be addressed in the Company's next rate case which it
20 has indicated it will be filing shortly.

21
22 **Q. So is it correct that Staff does not support a predetermination with respect to a new**
23 **ACRM-like Public Safety Surcharge in this proceeding?**

24 A. Correct. The Parties may advocate their positions in the next rate case. Nothing should be
25 predetermined in this proceeding to limit or preempt the Commission's rate options in the
26 next rate case. A future rate proceeding that allows for a comprehensive and full

1 consideration of all options is the appropriate vehicle for deciding any possible alternate
2 rate treatment of the high block surcharge collections.
3

4 The case has been reopened to specifically deal with the need for interim rate relief and
5 Staff believes that the Agreement goes beyond this rate issue when it addresses the design
6 of a future Public Safety Surcharge. Staff believes it would be inappropriate, even if
7 PVWD was not going to be filing a new rate case within weeks or months of the filing of
8 this testimony. Staff believes any new or recreated rate treatment of the Public Safety
9 Surcharge needs to be reevaluated in its entirety and not dealt with, in part, in this
10 proceeding. PVWD needs to reestablish its requirements and goals in its new rate case, so
11 that this Commission can properly evaluate the alternatives. The Town and Resorts can
12 intervene in that new proceeding so their issues can be raised and considered by the
13 Commission. Staff hopes that all parties now realize the importance of intervening in
14 cases before the Commission so all the issues of concern can be adequately presented by
15 the parties and thereby considered by the Commission.
16

17 **Q. What is Staff's assessment of the Agreement's proposal to reclassify monies received**
18 **from "contributions" to "revenues".**

19 **A.** The Agreement provides for the Parties to seek to complete the transition of the High
20 Block Surcharge from "contributions in aid of construction" to a "revenue-requirement
21 formula" in PVWD's next rate case. It also propose that the Public Safety Surcharge
22 would recover investments made after March 1, 2008, under a revenue requirements
23 formula. Staff does not believe that it is appropriate to alter at this time, the
24 characterization of the funds as "contributions" or "revenues". That is more properly
25 addressed in PVWD's next rate case.

1 **RECOMMENDATIONS**

2 **Q. What are Staff's recommendations?**

3 A. Staff recommends, that if the Commission desires to give some interim relief to the High
4 Usage customers and the resorts, the Commission grant the Petitioning Parties' request to
5 reduce the High Block Surcharge to \$1.00 per 1,000 gallons of usage and to eliminate the
6 current Public Safety Surcharge, for the interim period until the Commission reexamines
7 this issue in the Company's next rate case.

8
9 Staff further recommends that the Commission deny the Petitioning Parties' request to
10 design a future Public Safety Surcharge at this time. In addition, Staff recommends that
11 the Commission not approve a reclassification of the funds from the Public Safety
12 Surcharge from "contributions" to "revenues" at this time.

13

14 **Q. Does this conclude your Direct Testimony?**

15 A. Yes, it does.

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

DOCKET NO. W-01303A-05-0910

NOTICE OF ERRATA

Staff of the Arizona Corporation Commission ("Commission") hereby files this Errata to the Direct Testimony of Darron W. Carlson of the Utilities Division originally filed on April 25, 2008 in the above-referenced matter. Attached is a revised page 9 of Mr. Carlson's Direct Testimony. The changes appear on lines 10 through 13 of the testimony. Please substitute this page for the page 9 originally included in Mr. Carlson's testimony filed on April 25, 2008.

RESPECTFULLY SUBMITTED this 7th day of May, 2008.

Arizona Corporation Commission
DOCKETED

MAY -7 2008

DOCKETED BY NR

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1 **Q. Does Staff agree with the proposal in the Agreement to reduce the High Block**
2 **Surcharge and eliminate the Public Safety Surcharge until the Commission's Order**
3 **in the next rate case?**

4 A. Yes. Staff agrees with these recommendations. However, this should not preclude
5 reexamination of the issues in the next rate case, to the extent desired.
6

7 **Q. If the High Block Surcharge is reduced and the Public Safety Surcharge is**
8 **eliminated, how do the Petitioning Parties propose to make up for this reduction in**
9 **the Company's revenues?**

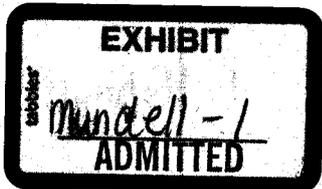
10 A. Since the funds from both of these surcharges are classified as contributions, their
11 reduction and/or elimination do not affect the operating revenues of the Company.
12 Additionally, the Company participated in its formulation, and Staff understands that the
13 Company is in agreement with the proposed reductions.
14

15 **Q. What is Staff's assessment of the Agreement's request to alter the future funding of**
16 **fire flow phases completed after March 1, 2008?**

17 A. Staff believes that it is inappropriate to entertain these types of alterations to the prior
18 Decision at this time. Staff recommends that all issues other than the
19 reduction/elimination of surcharges be addressed in the Company's next rate case which it
20 has indicated it will be filing shortly.
21

22 **Q. So is it correct that Staff does not support a predetermination with respect to a new**
23 **ACRM-like Public Safety Surcharge in this proceeding?**

24 A. Correct. The Parties may advocate their positions in the next rate case. Nothing should be
25 predetermined in this proceeding to limit or preempt the Commission's rate options in the
26 next rate case. A future rate proceeding that allows for a comprehensive and full



Arizona-American Water Company 7-25-2006
W-01303A-05-0405 Regular Open Meeting/Agenda Item No. 11
W-01303A-05-0910

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THIS TEXT WAS TRANSCRIBED FROM AN AUDIO RECORDING
BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE APPLICATION OF) Docket No. W-01303A-05-0405
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.)

IN THE MATTER OF THE APPLICATION OF) Docket No. W-01303A-05-0910
ARIZONA-AMERICAN WATER COMPANY)
FOR APPROVAL OF AN AGREEMENT WITH)
THE PARADISE VALLEY COUNTRY CLUB)

At: Arizona Corporation Commission
Phoenix, Arizona
Date: July 25, 2006

TRANSCRIPT OF PROCEEDINGS
REGULAR OPEN MEETING -- AGENDA ITEM U-11

Transcribed by Brenda G. Marshall
Executive Aide to Commissioner Mundell
May 13, 2008

1 BE IT REMEMBERED that an Open Meeting was held at the Arizona Corporation
2 Commission, 1200 West Washington Street, Phoenix, Arizona, commencing on the 25th day of
3 July, 2006.

4 BEFORE: JEFF HATCH-MILLER, Chairman
5 WILLIAM A. MUNDELL, Commissioner
6 MIKE GLEASON, Commissioner
7 KRIS MAYES, Commissioner

8 CHMN. HATCH-MILLER: We have a couple of elected officials I'd like to hear from
9 before they have to leave, so we're going to move to item U-11. We won't expect to go through
10 this item completely, we'll just get started until I have an opportunity for the public officials to
11 speak to us and answer any questions we may have.

12 ADMINISTRATIVE LAW JUDGE TEENA WOLFE: Mr. Chairman,
13 Commissioners, Teena Wolfe for the Hearing Division. This is a rate application by Arizona-
14 American Water Company's Paradise Valley Water District (Company). The Company
15 requested an increase of revenues for the district of \$427,939; for an increase of 8.43% over test-
16 year-adjusted revenues. RUCO recommended a decrease in revenues of \$436,532; for an 8.59%
17 decrease from test-year-adjusted revenues. And Staff recommended a revenue increase of
18 \$254,164; or 5% over test-year-adjusted revenues. Based on adjustments to the Company's
19 filing, the Recommended Opinion and Order (ROO) authorizes an increase of revenues of
20 \$199,371; which is a 3.93% increase over test-year-adjusted revenues of \$5,079,195; for a total
21 revenue requirement of \$5,278,566. The rates adopted by the ROO result in a monthly increase
22 from \$24.51 to \$26.37 or 7.13% for the average usage customer and a monthly increase from
23 \$16.81 to \$18.24 or 8.54% for the median usage customer; the median usage is 11,500 gallons a
24 month, and the average usage is 22,193 gallons a month.
25

1 The ROO also approves a high-block surcharge that will effect residential customers who
2 use more than 80,000 gallons of water a month and it will also effect commercial customers who
3 use more than 400,000 gallons of water a month and it will effect the customer, the Paradise
4 Valley Country Club under its turf irrigation rate if its usage exceeds 2,500,000 gallons a month.
5 This surcharge would charge an extra \$2.15 per 1,000 gallons effective with the new rates and
6 under the ROO the revenues from this high-block surcharge will go to pay for water
7 infrastructure improvements that are necessary to meet the Town of Paradise Valley's new Fire
8 Flow Ordinance and these revenues will be treated as contributions.

9 The ROO also approves an additional public safety surcharge of \$1 per 1,000 gallons to
10 apply to residential customers with usage of more than 25,000 gallons of water a month,
11 commercial customers who use more than 400,000 gallons of water a month, and also the
12 Paradise Valley Country Club if its usage exceeds 2,500,000 gallons of water a month. The
13 revenues from the Public Safety Surcharge will also go to pay for water infrastructure
14 improvements necessary to meet the Town of Paradise Valley's new Fire Flow Ordinance. After
15 the Fire Flow infrastructure improvements are paid for, the Public Safety Surcharge is designed
16 to terminate. The ROO also approves an Arsenic Cost Recovery mechanism and requires the
17 company to file a rate application no later than September 30, 2008.

18
19 Exceptions to the ROO were filed by the Company, RUCO and staff. Staff's exceptions
20 correctly pointed out an error in the ROO's interpretation of the alternative proposal provided by
21 Staff that's attached to the ROO as Exhibit D, regarding the Public Safety Surcharge and the
22 High-block Surcharge. I did misunderstand the effect of the alternative proposal regarding the
23 High-Block Surcharge and I've prepared Hearing Division Proposed Amendment No. 1, which
24 corrects the ROO to adopt the actual proposal that was made by the Starr, although not
25

1 recommended by the Staff; it was provided as an alternative. The Company's exceptions also
2 pointed out an error in the ROO regarding the surcharges application to commercial customers.
3 Hearing Division Proposed Amendment No. 1 corrects that error on the schedule of rates and
4 charges in the ROO and it also clarifies the application of the surcharges to the Paradise Valley
5 Country Club under the special contract approved by the ROO. And in addition, Hearing
6 Division Proposed Amendment No. 1 corrects several typographical errors.

7 CHMN HATCH-MILLER: Is that it, Judge Wolfe?

8 ALJ WOLFE: That's my summary.

9 CHMN HATCH-MILLER: Let's move quickly to RUCO because I know RUCO has
10 some concerns about this Order.

11 RUCO ATTORNEY, DANIEL POZEFSKY: Mr. Chairman, members of the
12 Commission, I'll try to keep this brief but it is a very important issue on what we're talking
13 about. The issue I'm talking about is the fire Flow Safety issue and improvements that are being
14 requested. The first point that I'd like to address is the scope of the Commission's authority. I
15 think this case and this issue really cuts to the scope of the Commission's authority and I'm
16 concerned exactly where the Commission would go if it adopted this Order. Specifically, all the
17 parties—I don't think anyone disagrees—that the Town Code that has been cited in the case,
18 which has set some fire codes standards, does not place the cost burden on the Company to make
19 the fire flow improvements. There's no issue there, so there's no law, there's no statute, there's
20 no Commission policy. Basically, this is a discretionary expenditure we're talking about. A
21 discretionary expenditure, the magnitude of which, will approximately double this Company's
22 rate base. The municipality should not be allowed to adopt rules that the Commission construes
23 imposes an obligation on the Company because, in effect, that impinges on Commission's
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1 ratemaking authority, which as the Commission has rightfully done so, it's been so, so concerned
2 with making sure that in effect doesn't happen, because the Commission's authority is
3 constitutionally exclusive and this is your institutional prerogative. Commission should not
4 exceed this but local government or municipality has not been talked about, and to rue this
5 notion of as why hasn't RUCO had the same argument as far as an impingement of the federal
6 rules or the federal laws on the Commission's authority in the courts as I explained in our
7 exception that's a different situation and the Commission is well aware that it has to give to the
8 federal authority under the supremacy clause.

9 Let me take this now to this notion of allowing only expenses that are necessary for the
10 provision of service. This Commission in numerous cases, and I can point to the APS rate case,
11 where the Commission has just taken this hard approach, and rightfully so, on excess
12 expenditures, on expenditures that are really only necessary for the provisioning of service.
13 Because we all know that when we start getting from this realm, we are starting to get into the
14 affordability of services, which is a critical issue in the case, especially with regard to utility
15 services. And the fact that the Commission needs or has made it clear that it's going to pretty
16 much cut the fat out of the utility spending and limit it only to these expenditures which are
17 necessary. And what I think you have here is fat that we're talking about. The concern, of
18 course, is are you going to start distinguishing between what types of fat you're going to cut and
19 what types you're not going to cut. I mean that only brings us into a real slippery slope. What
20 makes this any better than expenditures where company bonuses? And I know there's an
21 argument up there about....
22

23 CHMN HATCH-MILLER: Mr. Mundell.
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1 COMM MUNDELL: Well, counsel, wouldn't you agree there's a difference between
2 company bonuses and driving around in, you know, expensive cars, as opposed to a public safety
3 issue? Wouldn't you make, wouldn't you agree there's a; whether you agree with this Order or
4 not, wouldn't you make, is there a public policy issue there making a distinction between
5 extravagant expenditures and one that deals with public safety?

6 ATTY POZEFSKY: Well, yes.

7 COMM MUNDELL: And wouldn't most people? So I assume you start from the
8 premise that you agree that there ought to be adequate pressure in the event of a fire. You agree
9 with that?

10 ATTY POZEFSKY: Yes.

11 COMM MUNDELL: Okay; so then the question is: how do you pay for it?

12 ATTY POZEFSKY: Yes.

13 COMM MUNDELL: And you would agree there is a distinction between your example
14 you started to give us about executive bonuses and fire flow protection?
15

16 ATTY POZEFSKY: Well, I think the way I would put that is, and here's where we go
17 because we're starting to talk about discretionary expenditures. Let's say you have a situation
18 with an expenditure on a bonus where you have an executive, and I mean I'm just giving you a
19 hypothetical, who'll no longer work unless he's paid some ridiculous bonus but it's clearly in the
20 public's interest because (inaudible) this executive has worked so well for this utility to keep this
21 executive. Now we have a situation where we have a bonus which really shouldn't be spent but
22 it's still in the public's interest, it could be argued, to keep this executive. Again, what I think
23 I'm trying to point out, and it can get murky, and it can get murky fast, and that's why it brings
24 in the slippery slope of discretionary expenditures.
25

1 COMM MAYES: Mr. Chairman? Could I?

2 CHMN HATCH-MILLER: Certainly, Commissioner Mayes.

3 COMM MAYES: Mr. Pozefsky, I understand what you're trying to get at, it just
4 seems to me it's an argument taken to the absurd. So, let me ask you a couple of questions that
5 might be more relevant to my understanding of your position. Would RUCO have been more
6 comfortable with this request if we had done it in the same way that we did the Sun City
7 Arizona-American case where Commissioner Mundell's amendment passed setting up a task
8 force? A task force that came together, worked together; and then I think the company who is
9 intending to come in with a rate increase request that is somewhat based on the recommendations
10 of the task force, or does that not alleviate your concerns?

11 ATTY POZEFSKY: I don't believe it would alleviate our concerns, because what I
12 think you're talking about there again is the necessity of this service to the community. And our
13 concern, we don't argue, we don't take issue that the community needs public improvement of
14 this nature. That's never been our issue; you can get a task force that can conclude that. Our
15 issue is: who should pay?
16

17 COMM MAYES: Okay. And your position is it's the municipality that should pay?
18 Who would pay?

19 ATTY POZEFSKY: That's not our issue....

20 COMM MAYES: Okay.

21 ATTY POZEFSKY: ...who should pay. Our issue, should the Commission approve it:
22 should ratepayers pay?
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1 COMM MAYES: But the Commission has the statutory authority, and I'm sorry I
2 don't have the citation in front of me, to order a public service company to implement a plant, do
3 we not?

4 ATTY POZEFSKY: You do.

5 COMM MAYES: That we find to be necessary to, for instance, the public health and
6 safety of a particular service territory.

7 ATTY POZEFSKY: And I would never, Commissioner Mayes, make the argument that
8 the Commission can order this. That's not the argument. What I would make the argument, is
9 it's nowhere in the Commission rules that the Commission is going to more-or-less adopt a fire
10 flow standard. That's not something that's been in the Commission's rules; it not designated by
11 statute. It is not a statute or a law. That's not what the commission does; the Commission
12 doesn't set fire flow standards, if you will. But if you, excuse me, I wouldn't argue with you if
13 you said, can you do it? I would say you can. But, again, can you prove discretionary expenses?
14 Again, in some situations, yes, you can be. Should you approve, are you setting a policy or
15 standard that you really want to be heading down? When you do get the APS's and you do get
16 the other situations where you're having discretionary expenditures at issue, they're going to
17 start saying well, hey, you're going to be starting up a precedent which it's easily to come back
18 at you and start saying, what are you going to do? Are you going to start making these
19 distinctions in here? And then, I guess, to follow that, is why would you do that now? What's
20 different about this situation than the next case? We already know that companies have
21 discussions with other municipalities about fire flow. You're going to probably see this again,
22 and you're going to be asked, and it's really going to probably be no different than now, and then
23 you going to be forced to make a decision in that case. Eventually, we're talking about this
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1 whole affordability of water. I mean, are you going to be getting into the situation where you're
2 doubling a company's rate base, or, you know, increasing rate bases?

3 COMM MAYES: Because of fire flow. And, I think that is really the nub of your
4 argument. And that's what I got from your briefs and the testimony, which is you believe this is
5 setting a precedent that will be used by other companies that might want to come in and
6 artificially inflate their rate base by saying, hey, we're going to make these dramatic
7 improvements to fire flow. My response to that would be and in my reading of the record and
8 the judge's recommended order, is that she's very careful to point out that this is not, that these
9 are under the specific circumstances of this case. It's essentially not meant to be precedent, but I
10 understand your concern.

11 ATTY POZEFSKY: And my response to that, the Order and the fact that it's in there
12 is—yes, it is in there--but if you're thinking no, no, no down the line when this gets asked,
13 especially in situations like areas where you do have marginal people that are really living on the
14 margin, you know, what is going to distinguish that? Why would you do it now? What is going
15 to distinguish it now? So, it comes back to that. Yeah, it's nice to see it in there but it's just not
16 a good policy to getting into to begin with. And you're not really distinguishing it now other
17 than, perhaps, you've got a population base that maybe has a higher income. And that this very
18 same company owns ten other systems that we know of and they're certainly going to want the
19 same treatment.
20

21 CHMN H-M: Along those lines, and I should have come prepared with the names of
22 these communities, but Saddlebrook comes to mind; Anthem comes to mind. Those
23 communities do have systems set up for fire flow standards, don't they? I mean, I believe they
24 do.
25

1 ATTY POZEFSKY: I don't know for sure.

2 CHMN H-M: I guess going forward and saying, well, how should we proceed? If we
3 went down your line of reasoning, how should we proceed in new developments where a private
4 water company subject to the jurisdiction of this commission was expected to provide a system
5 that met the national and state – well, there really isn't state fire flow standards. The fire flow
6 standards, as I understand it, have to be adopted by the municipality; so the only ones that have
7 the authority to do it. So, either the federal safety association – it's not usually a government but
8 there some recommended standard; it's like the building codes for what the system ought to
9 include. How should, so we have a new application for a CC&N and they're talking about a
10 water company providing water service that would include fire flow, meeting fire flow standards,
11 how should that be handled?

12 ATTY POZEFSKY: Well, Mr. Chairman, generally fire flow standards are covered
13 under line extension agreements, developers would be paying for them in the form of a
14 contribution in advance. That's generally how it happens.

15 CHMN H-M: And not the; so in other words, they'd already build to the standards of fire
16 flow.

17 ATTY POZEFSKY: Yeah, that would be correct. Or, if they needed funding for it
18 again, that's how they would do it. And I believe out of those ten, Mary Diaz Cortez advises me
19 about three of them do have those standards.

20 CHMN H-M: Okay, And then what about those communities that were fairly rural, and
21 were in the state a number of years ago fairly small populations that have now, as like Maricopa,
22 all of a sudden there's an extension of lots of new development in the community but there's
23 areas that don't have the same services provided to them. How should new public safety
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1 standards be provided to those members of the same community. I saying there's probably the
2 same municipal government, just one area is brand new with these line extensions, the other
3 areas doesn't have the line extension agreements –or would they have?

4 ATTY POZEFSKY: Well, in that situation, I think typically, I mean we haven't seen it
5 with this community, but by floating bonds and municipalities floating bonds and paying for it
6 through their municipality.

7 CHMN H-M: And so they would build a totally separate system from the water system?

8 ATTY POZEFSKY: **Well, this gets into that issue that (end of tape 1)**

9 TOWN OF PARADISE VALLEY ATTORNEY, ANDREW MILLER: **(beginning of**
10 **tape 2)** Researching what are the different options, and could we actually give money to the
11 water utility for the lines. And like I said, I did talk to bond council. I think one of the important
12 distinctions in the case that was decided by RUCO's counsel is that, in the town of Gila Bend
13 case, the town did ultimately continue to own that line and that line could eventually be used in
14 the future for other public safety purposes. The difference here is we wouldn't be owning these
15 lines. These would be lines that would be used by or owned by the private utility. That line – as
16 far as I could tell – was not to be used by a private utility. It was exactly what I said we could do
17 and that is build a completely separate set – a redundant set – of fire lines and the town would
18 have authority to do that. We could go into our public streets, which we own, and put fire lines
19 all throughout the town. We'd have to buy water from the water utility on some kind of a
20 commercial account basis and we could do that. But I don't think there's any authority that says
21 that we can get into a joint partnership where part of the water that they've floated to domestic
22 customers can flow through lines the town is owned, financed, or subsidized. I think that's
23 pretty clear by the constitutional case and also by the case that was cited.
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1 CHMN H-M: Commissioner Mundell?

2 COMM MUNDELL: Well, just a couple of things I want to respond to. And I guess
3 we're not going to go to Commissioner Gleason's amendment before we break, but it's pretty
4 clear that the town opposes Commissioner Gleason Amendment, is that correct, Mr. Miller?

5 ATTY MILLER: I would say, yes. But of course, that amendment came; but I
6 would say, yes the town does oppose it based upon the prior call directive I'd gotten which was
7 to go ahead and do an Amicus Brief. And I guess I should correct myself, I was thinking back
8 there. The council did authorize, by resolution, me to file an Amicus Brief in this rate case
9 supporting basically the amendment to allow the rates to increase, and particularly to address the
10 issue of the gift clause as well as another statute which requires you have a public vote before
11 you can get into the utility business. And so they are aware of that, and they did pass a
12 resolution. As I was thinking back there, they haven't been specific we support this rate increase
13 but I say, indirectly, they very much have given that support by authorizing me to file that
14 Amicus Brief, and a copy of this resolution - I believe - is attached to the Amicus Brief, as well.

15
16 COMM MUNDELL: Thank you, Mr. Miller. I appreciate that clarification, because I
17 thought I'd read where there had been some kind of a vote by the major and city council on an
18 issue, so I appreciate that clarification. And to Commissioner Gleason's and to RUCO's
19 argument that we're going down a slippery slope, on page 12 of the Order, line 9, it specifically
20 says: "Our decision in this matter is limited to the facts before us in the proceeding and it's not
21 intended to, and should not be interpreted to set policy with regard to fire flow improvements. In
22 the event a similar issue arises in another rate proceeding, for another regulated water utility, the
23 Commission shall consider the issue based on the totality of the facts and circumstances at the
24 time." So, the Judge put that language in there I think to address specifically whether this could
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1 be used as precedent in another proceeding, and it's clear it can be and it's limited to the unique
2 facts and circumstances of this case. And I'll have a verbal amendment to clarify her sentence
3 because she says "another"; I would just say "a" regulated water utility as opposed to "another"
4 regulated water utility, because we say "another" twice in that sentence. I just want to clarify it.
5 In any future proceeding this would not be precedent setting order, if we in fact adopt it. And
6 then, one last thing, I agree with the legal position that RUCO is taking on the gift clause. I
7 disagree with the town but this doesn't end my analysis of this decision in whether or not this is a
8 reasonable alternative to finance the fire flow. I just disagree. I think you could make a very
9 strong legal argument that this is not a gift, and in fact, it's in the public interest, and the
10 Supreme Court would approve some kind of mechanism other than what we have before us.

11 CHMN H-M: Thank you very much, then, Mr. Miller. Are you going to be available
12 this afternoon?

13 ATTY MILLER: Yes, I will.

14 CHMN H-M: Okay, great. So, we're going to take....can we take a short recess...45
15 minutes? Take a 45 -minute recess and we'll come back at 1:45 pm.

16 CHMN H-M: Welcome back. Our little extended break there...55 minutes, well, 50
17 minutes. I hope you enjoyed a leisurely walk around. We're going to resume our discussions
18 now of Item U-11. Before the break, there was still one person here to make public comment.
19 Ms. Mary Leibsohn. I believe so, if you'll come forward, resident of Paradise Valley, I believe.
20

21 MS LEIBSOHN: That's right. I have lived there for 40 years, and I'm thrilled at
22 what you've done. Obviously, it's going to pass. But, not everyone is in one hundred percent
23 agreement. (Inaudible for approximately one minute.)
24
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1 CHMN H-M: Can you pull the microphone a little closer to you? Just pull it straight out,
2 towards you, bend it, straight there.

3 MS LEIBSOHN: Thank you. Shall I start all over?

4 CHMN H-M: No, no, you're doing great.

5 MS LEIBSOHN: Okay. I started going to the meetings because of the fire
6 department in '03, in '05. In that time I found out there was a five-year plan for improvements,
7 which I was thrilled about. And however, our area of the community would not benefit.
8 Arizona-American, Steven Greenbury (?), Brad Anderson (?) have been wonderful amongst a
9 number of times last year. Steve came out and he ran the pressure in our hydrants, and it was
10 just 1300 gallons per minute. The Town, the Chief of Police and Chuck Fitzgerald has been
11 marvelous trying to make us feel – those of us as homeowners on the hillside – feel that we are
12 protected. I spoke to the State Fire Marshal, and of course, they don't have a code, it's up to the
13 local district. However, there's a planning division and that gentleman told me for homes of
14 3600 square feet, they recommend a 6-inch pipe and 15—13—1500 gallons, or it's 1300—I
15 can't remember, but that's not the issue. We are north of McDonald, we're south of Pine. The
16 plan is going up 44th Street, over to Desert and Lincoln, where I guess they're putting a pump. I
17 have spoken to Steve, to the Chief of Police, Chuck Fitzgerald and they say even if they have
18 budget money, our 3 cul-de-sacs: 41st Place, 42nd Street and 43rd Street, will not be included.
19 We have 4-inch pipes, as I said; 41st Street has 6-inch pipes; Pine, north of us, has 6-inch pipes;
20 44th Street is going to have a 16-inch pipe; McDonald has 6-inch pipes. Now what people tell us,
21 and I understand that and I'm sure it's true, that in the planning we will all benefit from that extra
22 work. However, for the homeowners on our 3 cul-de-sacs, as far as we're concerned, we're all
23 hilltop and we have 4-inch pipes. And over the years, we think that just wrong. So, as I say,
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1 we're pleased with everything they're doing. We wish we would be included in the plan and
2 we're registering our, you know, discomfort with this. And I have to say everyone was
3 wonderful, however, nobody, they say it's too expensive and that they can't do it. I can
4 understand their restraint but I just, as I said, want to tell you that's the way the 3 cul-de-sacs
5 people, particularly on my street, are saying, well, why should we pay for something that we
6 don't think we're getting. You know, there's an understanding but we wish it weren't so, and so
7 everyone isn't thrilled. If you have any further questions...

8 CHMN H-M: Well, I do know that there are several new fire hydrants in that general
9 neighborhood because I saw them go in. I've seen them go in, but not in your cul-de-sacs.

10 MS LEIBSOHN: Yes, I have one right at the back of my house.

11 CHMN H-M: A new one?

12 MS LEIBSOHN: No.

13 CHMN H-M: Oh. No, I mean they put some new ones in that area.

14 MS LEIBSOHN: (Inaudible) at 41st Street and (inaudible) and that is 6-inch pipes.

15 CHMN H-M: Commissioner Mayes.

16 COMM MAYES: Thank you, Mr. Chairman. Is the issue; you're talking an issue
17 about the fire hydrants or about the size of the pipes?
18

19 MS LEIBSOHN: I'm talking about the pipes.

20 COMM MAYES: Okay, so that a different....okay.

21 MS LEIBSOHN: Gallons per minute on my street, that was fine. And Steve from
22 Arizona-American, he ran that for us. I said he was very cooperative and tried to make us feel
23 more comfortable and we even have a new -- you know--blue light in front of our street to show
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1 where everything is. But we just – you know—feel very left out and would the plan to have been
2 involved in a different manner.

3 And I'll go (inaudible) over the plans.

4 COMM MAYES: Well, maybe we can ask some questions of the company about that
5 and why you were left out of the plan and maybe how we can progress.

6 MS LEIBSOHN: Well, what I understood was budget, but maybe it was not. We're
7 in an area called "The Boot" and there's just a small group. I think perhaps there hasn't been
8 that much activity into or people involved in the town council, or the town politics or business
9 over time. I think we all became much more involved over the fire department, that kind of
10 (inaudible). Anything else?

11 CHMN H-M: Thank you so much for coming here today and further clarifying.
12 Commissioner Mundell, do you want to move? Do we want to talk to the company, I guess,
13 first? Representative of
14 Arizona-American come forward. Is that you, Mr. Marks?

15 CRAIG MARKS: Thank you Chairman Hatch-Miller, Commissioners. Craig Marks on
16 behalf of Arizona-American Water Company. At lunch time, I was congratulated on probably
17 doing the best job I'd ever done with the Commission this morning, so far. I don't want to do
18 anything to jeopardize that impression that people have, so I'm going to keep my remarks very,
19 very brief and then I'll just take any questions that you might have and to the extent that I can
20 answer them, I'll be happy to. I did want to correct one impression that may have been
21 inadvertent on the record this morning. Mr. Pozefsky said that the investment would double the
22 company's rate base. And, I'm sure as you all know, the plan as is contained in the Proposed
23 Order, the additional plant will be funded with contributions so net rate base will not be effected
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1 as the surcharge funds come into the company, based on that. The second thing I just wanted to
2 make clear: there was some discussion this morning about residents outside of the common
3 Paradise Valley. There are a number of customers, I believe it's around 1500 customers in
4 Scottsdale and there are a few customers in the unincorporated area of Maricopa County – kind
5 of a county island between Scottsdale and the Town of Paradise Valley. The testimony in the
6 record is that all customers throughout the service territory will benefit from the planned fire
7 flow improvements and that most customers in Scottsdale, because of the size of the homes in
8 this particular area, will not end up have any cost impact as a result of the high block use
9 surcharges. That's all I wanted to add to the record. I'll be happy to take any questions.

10 CHMN H-M: Commissioner Gleason, Commissioner Mayes.

11 COMM MAYES: Mr. Marks, could you explain the situation that was just related to
12 us by the individual from the area known as "The Boot" and why that is so?

13 MR MARKS: I cannot explain that, it's the first I've heard about this issue. Mr.
14 Broderick says that he has some information on it. Could I bring him to the stand?

15 COMM MAYES: Sure.

16 MR MARKS: Thank you.

17 TOM BRODERICK: My name is Tom Broderick. Thank you – Arizona-American
18 Water Company. And we know the situation with Mary Leibsohn quite well, and I'll probably
19 also want to bring up our Engineering Director, Joe Gross. We tested the area where Mary lives
20 last Tuesday, and we must acknowledge we're not focused on the size of the pipe. We're
21 focused on gallon per minute for the period of time – that's the standard. And her area tested at
22 1375 gallons per minute. So we have a large number of other areas in the community that are
23 testing at way, way less than that; we're talking 500 gallons per minute or less. And, so it's true.
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1 The projects in her area are known as projects "17" and "17A". They're at this point, they're not
2 actually scheduled. They were one of the ones deferred towards the end. As you know, we were
3 originally proposing rough a five-year timeframe. So, it's certainly not true that we're not doing
4 anything in that area, but it's not true that we haven't scheduled something, yet. And, we stand
5 on the fact that, like we say, we tested about 1375. We do think that as we do the other larger
6 areas, there's a good chance that her area will go over 1500 gallons per minute by doing nothing.
7 Okay. So we may be able to reach that standard with probably within one or two years, maybe.
8 Mr. Gross could verify that, and that would be the end of the story. So we're continuing to test.
9 Like I say, we just tested her area last Tuesday and she already knows the results.

10 COMM MAYES: And you'll continue to remain in touch with those residents?

11 MR BRODERICK: Oh, absolutely.

12 COMM MAYES: But, that's in the plan? It's what, toward the end of the plan?

13 MR BRODERICK: Yes, it's in the plan. It was identified in that earlier task force
14 process. And in the prioritization, it's one of the last in that priority. And, yeah, it absolutely
15 will depend on how project funding goes. As you know, we're paying, we'll be doing this
16 project mostly on a pay-as-you-go. As the contribution funds come in, we'll be doing the
17 projects and we'll be managing to that as we go through time. You know, in the Recommended
18 Order, the high blocks, the public safety surcharge -it doesn't go away until we're finished. So,
19 I mean, I think there's still a lot of history yet to write. I suspect we'll be here, you know -
20 we're going to file another rate case September '08, so you'll be hearing from us again well
21 before we're anywhere finished in Paradise Valley.
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1 COMM MAYES: Okay. Mr. Broderick, while I have you; you understand, for the
2 record, this is not a precedent-setting decision with regard to the issue of, that was discussed this
3 morning and the issue of our disposition of fire flow improvements?

4 MR BRODERICK: That's correct. And I believe in the other communities we know
5 about, there will be different facts and we will have to look at those each very carefully.

6 COMM MAYES: Separately and distinct, and by their own circumstance.

7 MR BRODERICK: That's right.

8 COMM MAYES: Okay. The property tax issue – this test year was 2004. Were
9 there any benefits that accrued to the company as a result of any property tax cuts in that year?

10 MR BRODERICK: Not that I'm aware of.

11 COMM MAYES: Okay. Those began, I think, in 2005 and 2006.

12 MR BRODERICK: I'm not aware of any property tax cuts.

13 COMM MAYES: I thought we had some in 2005; certainly in 2006 you'll be
14 receiving significant benefits.

15 MR BRODERICK: We're not aware of any property tax cuts affecting our property.

16 COMM MAYES: In the state of Arizona?

17 MR BRODERICK: For water utility property.

18 COMM MAYES: Well, that's odd. Okay, well....

19 MR BRODERICK: Certainly not to date.

20 COMM MAYES: I've been involved in several cases where that was taken into
21 account in the Recommended Order. You're not aware of that?

22 MR BRODERICK: It didn't come up in our case. We were not aware of any.
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1 COMM MAYES: Okay, so you're not going to benefit from the property tax cut that
2 was just passed by the Arizona Legislature?

3 MR BRODERICK: What bill number would that be, Commissioner Mayes?

4 COMM MAYES: I don't remember, but it was pretty hefty.

5 MR BRODERICK: If it was Senate Bill 1342, that bill was vetoed.

6 COMM MAYES: Well, no. I'm talking about; there were tax cuts that were passed
7 that I think, will accrue. It may not have been that bill.

8 MR BRODERICK: We have not analyzed...

9 COMM MAYES: No, I'm not talking about the bill that we supported. Is that what
10 you're talking about?

11 MR BRODERICK: That's the one I was talking about. We have no analysis of any
12 property...

13 COMM MAYES: Well, it's not relevant to this case, but we'll obviously be talking
14 about it in future cases. Can you explain your position that the company took, with regard to
15 your annual incentive program and why that should have been recovered? Your argument was
16 that 100% of that should have been recovered from the ratepayers?

17 MR BRODERICK: What I'd like to do, I have our president, Paul Townsley, who was
18 a witness on that topic in that case; if I could defer to Paul and have him discuss that. Is that
19 okay, Chairman Hatch-Miller? Thank you.

20 MR TOWNSLEY: Good afternoon. Paul Townsley, President of Arizona American
21 Water Company.
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1 COMM MAYES: Why did you think the entirety of that should have been collected
2 from ratepayers?

3 MR TOWNSLEY: Chairman Hatch-Miller, Commissioner Mayes; for a number of
4 reasons. I have advocated that the incentive program should be included in rates. First of all,
5 just so that you understand how our incentive program is constructed, there are three
6 components: There's a financial component, there's an operational component and there's an
7 individual component. For our managers in Arizona, approximately 70% of the incentive plan is
8 non-financial, so it's operational and individual. And, the types of things that are included in the
9 incentive plan are targets that are designed to improve the ability of our utility to provide good
10 quality service for our customers. As an example, in our operational targets, we have measurers
11 such as the number of notices of violations of water quality standards, our safety record, and our
12 customer service measurements out of our call center or in terms of the types of interactions we
13 have with customers. Typically, on the individual component of the incentive plan, that also has
14 very operationally and customer service focused targets. We each develop targets across the
15 year as part of our annual incentive program and as an example, I have targets that are to
16 improve our customer service, to improve the way that we are able to retain employees, to
17 improve the training, and our organization, which would fall out and create employees better
18 able to service our customer needs. And even on the financial component, the financial
19 component was really focused on improving the ability of Arizona American to attract capital, to
20 be able to continue to invest in our infrastructure here in the state, and to be able to earn a
21 reasonable return on the investments that we already have. And so, I strongly believe, and in my
22 testimony I've stated that both short-term and long-term, the incentive plan does benefit our
23 customers here in Arizona. And that's why I believe that this commission should approve that.
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1 If we did not have the incentive plan, as a part of our compensation, we would simply have to
2 look, perhaps raising salary levels of employees, of eligible employees, so that we could
3 continue to be competitive in the labor market here. I mean, in all honesty, with all of the
4 development that's going on in the state, with all of the new infrastructure that's being built in
5 the state—new treatment plants, new pumping stations, new underground pipelines—it is very
6 difficult for us to continue to attract civil engineers, licensed operators, operational supervisors
7 and the like. And we have been undergoing a process over the past few years to make sure we
8 continue to be competitive in that labor market. The annual incentive program is simply a part of
9 our overall compensation package to allow us to be competitive.

10 COMM MAYES: Going to a different issue, part of this case involves your arsenic
11 cost recovery mechanism. Is the Paradise Valley system growing to any degree?

12 MR TOWNSLEY: The Paradise Valley system really is not a growing system. There
13 is some growth in the sense that people will take an old home and tear it down and build a larger
14 home that might use new, more water. But unlike come of our other service areas in Arizona, I
15 would call this a fairly static system.

16 COMM MAYES: Okay. So therefore, you didn't examine or haven't examined an
17 arsenic hook-up fee as a possible remedy?

18 MR TOWNSLEY: This is correct, because we simply don't have very many new
19 customer hook-up in Paradise Valley. In other areas, such as other parts of our system where we
20 do have much more rapid growth and we are interested in hook-up as an offset to the arsenic fee.

21 COMM MAYES: When you say you "don't have very many", what does that mean?
22 What's your annual or yearly growth?
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1 MR TOWNSLEY: In terms of new customers? Let me see. Probably less than 15
2 customers per year.

3 CHMN H-M: Commissioner Mundell.

4 COMM MUNDELL: Thank you, Mr. Chairman. I just want to follow up on what was
5 said earlier. Even though the woman who testified, or made a public statement, her area is at the
6 end of the list – for lack of a better word – where the improvements are taking place. Was it
7 my understanding that, notwithstanding that, because you're improving the rest of the system,
8 her water pressure may, in fact, increase dramatically in the near future? I just want to make sure
9 I understand what was said by Mr. Broderick.

10 MR BRODERICK: I can answer that I think Joe Gross, who is our engineering director
11 would be able to answer that even better than I could.

12 MR GROSS: Mr. Chairman, Commissioner Mundell, my name is Joe Gross,
13 engineering manager of Arizona American. The answer to your question is, yes. And here's
14 why: the water committee of the town, town officials and company official, agreed upon a
15 prioritization of all the improvements made for fire flow in the town. The first priorities were to
16 improve the back fountain bone structure, the main roads: Lincoln Drive, Tatum Boulevard,
17 McDonald Drive and that's where we are today. We've made some improvements, we have
18 designed others. The point is that those improvements, in themselves, will increase the water
19 pressure out in the distribution systems. And until they're in, and the pressures have been
20 measured, that will lead us to follow on action to benefit almost all the residents.

21
22 COMM MUNDELL: Right, that's what I thought Mr. Broderick said, but I just wanted
23 to confirm it. So, she may not have wait 5 years, or until the end of the improvement, that
24 prioritizations that are taking place?
25

1 MR GROSS: No, in fact, it is my understanding the recent improvements last year in
2 McDonald Drive; it improved the water pressure in her neighborhood already.

3 COMM MUNDELL: And Mr. Broderick said she just got a recent measurement of water
4 pressure. So, we could have some basis, at one point it was what pressure? And now, what's the
5 most recent reading? That gives us sort of some...

6 MR GROSS: I don't have the exact figures, Commissioner. But, I believe, originally, it
7 was under 1000 GPM, and now it's up to 1300.

8 COMM MUNDELL: Thank you, sir. And then, maybe you're not the right person to ask
9 this, but I know that in the Order we have a tier system and it indicates what the average usage is
10 and the median usage. Can someone be prepared, at some point in time, I'll just give you a
11 head's up right now, sort of go through the difference tiers and tell me how many customers are
12 in each tier. I mean, we go 1 gallon to 25,000, that's the 1st tier; the 2nd tier is 25,000 to 80,000;
13 over 80,000 is the 3rd tier group for residential. I just want to get a feel for how many are in each
14 tier. I know what the average usage is, but I don't know what the number is.

15 MR GROSS: Commissioner Mundell, I can't answer that question. But we'd be
16 prepared to answer that at another time.

17 COMM MUNDELL: Thank you, sir.

18 CHMN H-M: Thank you, Mr. Gross, very much. Mr. Mundell, why don't you move the
19 item, if you wish to.

20 COMM MUNDELL: Yes, Mr. Chairman, I'll do that. I'll move U-11.

21 CHMN H-M: Thank you very much. Let's entertain the amendments. The first is the
22 Hearing Division proposed Amendment #1. Your Honor.
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1 ALJ TEENA WOLFE: Mr. Chairman, Commissioners. Hearing Division proposed
2 Amendment #1 correct typographical errors. It also corrects the error in my interpretation and of
3 the surcharges as proposed in Staff's alternative recommendation, and it corrects other
4 typographical errors that were pointed out by the company.

5 CHMN H-M: Okay. The company is aware of these changes? Does the company have
6 an comments?

7 MR CRAIG MARKS: Thank you, Chairman Hatch-Miller. Craig Marks, again.
8 Yes, we are aware of those and we do support Hearing Division Proposed Amendment #1.

9 CHMN H-M: Thank you very much.

10 COMM MUNDELL: I'll move Hearing Division Amendment #1, Mr. Chairman.

11 CHMN H-M: Thank you very much. Anything further on this item? All those in favor
12 of Hearing Division's proposed Amendment #1, signify by saying "Aye." Aye, all opposed
13 "nay." It's unanimous. Mr. Gleason, you have a proposed amendment?
14

15 COMM GLEASON: Yeah, I move Gleason Amendment #1.

16 CHMN H-M: Explain it please.

17 COMM GLEASON: Well, we've kind of beat this around all morning, so...it boils
18 down to the fact that this is something the city can do and should do. It's as simple as that. They
19 seem to want the "red herring" of putting in two lines. They can do exactly what they've asked
20 Arizona American to do, and RUCO says they can finance it. As I've been listening to this
21 precedent thing, I really didn't expect the ALJ to say this is the precedent that's going to be
22 enforced on all the other cases that we hear on this. But it is a precedent and it will be used.
23 You can say all you want to but it's going to be used. I've sat up here long enough to know it's
24 going to come back again. And, on that case, I think RUCO's contention that we may be at the
25

1 top of a slippery slope is valid. We're going to hear this again; we're going to have to worry
2 about charges that are not necessarily pertinent to the rate case and we'll be arguing this again
3 and again and again, now that we've started down that slope.

4 CHMN H-M: Thank you very much. Any further discussion on this amendment?

5 Gleason proposed Amendment #1 to the Order. All in favor signify by saying "Aye"; all
6 opposed, say "nay". No's have it.

7 COMM MUNDELL: The only issue I have left, Mr. Chairman, before I move the item as
8 amended, and maybe this is clean-up, and I ask the Administrative Law Judge – we have an
9 Exhibit B attached to the Order, and I think that was an exhibit that was introduced into evidence
10 by Staff. But that's not, as I understand it. I thought it conflicted with the findings of the Order.
11 I just wanted to know if you think it'd be confusing to keep it attached to it or to have it not part
12 of the Order?

13 ALJ WOLFE: Mr. Chairman, Commissioner Mundell, I attached it to the Order for the
14 convenience of the reader to see what the alternative proposal was. Whether it's attached to the
15 final Order or not, doesn't make any difference. It would require some conforming changes to
16 remove reference to it being attached.
17

18 COMM MUNDELL: Oh, well, I understand why you did it for the convenience factor. I
19 just didn't know if someone were to come to look at the Order and they would just reference the
20 Exhibit and to you, it wouldn't present a problem if I was just coming to the Docket and I'm
21 looking at the Order and trying to figure out what the rates are. I guess if the Company knows,
22 and RUCO knows and Staff knows, it doesn't present a problem.
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1 ALJ WOLFE: Mr. Chairman, Commissioner Mundell, I think that the controlling rate
2 schedule is that that appears, beginning on Page 41 of the Order of the tariffs that area adopted
3 when the Commission adopts the Order.

4 COMM MUNDELL: Well, if everybody else is comfortable with it, that's fine. I just
5 thought I'd raise the issue so we could talk about it. Hearing no other objection or agreement, I
6 won't do anything. I'll move U-11, as amended.

7 CHMN H-M: Thank you, Commissioner, I appreciate that. Any further discussion of
8 Item U-11? Hearing none, Madame Secretary, you can call the roll:

9 COMM MAYES: Thank you. I'm going to vote aye on this matter. I think it
10 represents reasonable resolution of long standing issue in Paradise Valley, which is obviously the
11 fire flow issue. I actually agree with Commissioner Gleason these issues are better addressed by
12 local towns and cities. I agree with RUCO's position on the gift clause that it would not have
13 applied in this case. That being said, I think that our job as commissioners is to protect the
14 public, health and safety of the people who take service from public service corporations and we
15 have the ability under our statutes to order these kinds of improvements to be made, so I think
16 it's appropriate for us to approve them in this case. I appreciate all of the parties' hard work on
17 this matter. I would just add, Mr. Broderick, the bill I was referring to—maybe we were talking
18 past each other—was HB 2876, which was passed by the legislators and signed by the governor
19 and does include a property tax reduction and a significant benefit to businesses in the state of
20 Arizona. I think it's something that the Commission is going to be addressing rate case by rate
21 case. I vote Aye. Thank you.
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23 COMM GLEASON: Yeah, ah, I really want to thank RUCO for bringing up this
24 question. It's a policy question, it's an important question, it's something we're going to see
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1 again. I think it gets back to this thing the people that cause expenses should pay for them.
2 That's basically what we were talking about on this amendment. The people that wanted that
3 fire flow should pay for it and that was the city. I think the city got some poor legal advice
4 before that, I think RUCO is right; the city could do this, should do this and I think the precedent
5 thing, again RUCO is right; we're going to see this again. We're going to argue again. I hope
6 you're here to argue it again, but that being said, they do need some of the other factors to the
7 bill, so I vote Aye.

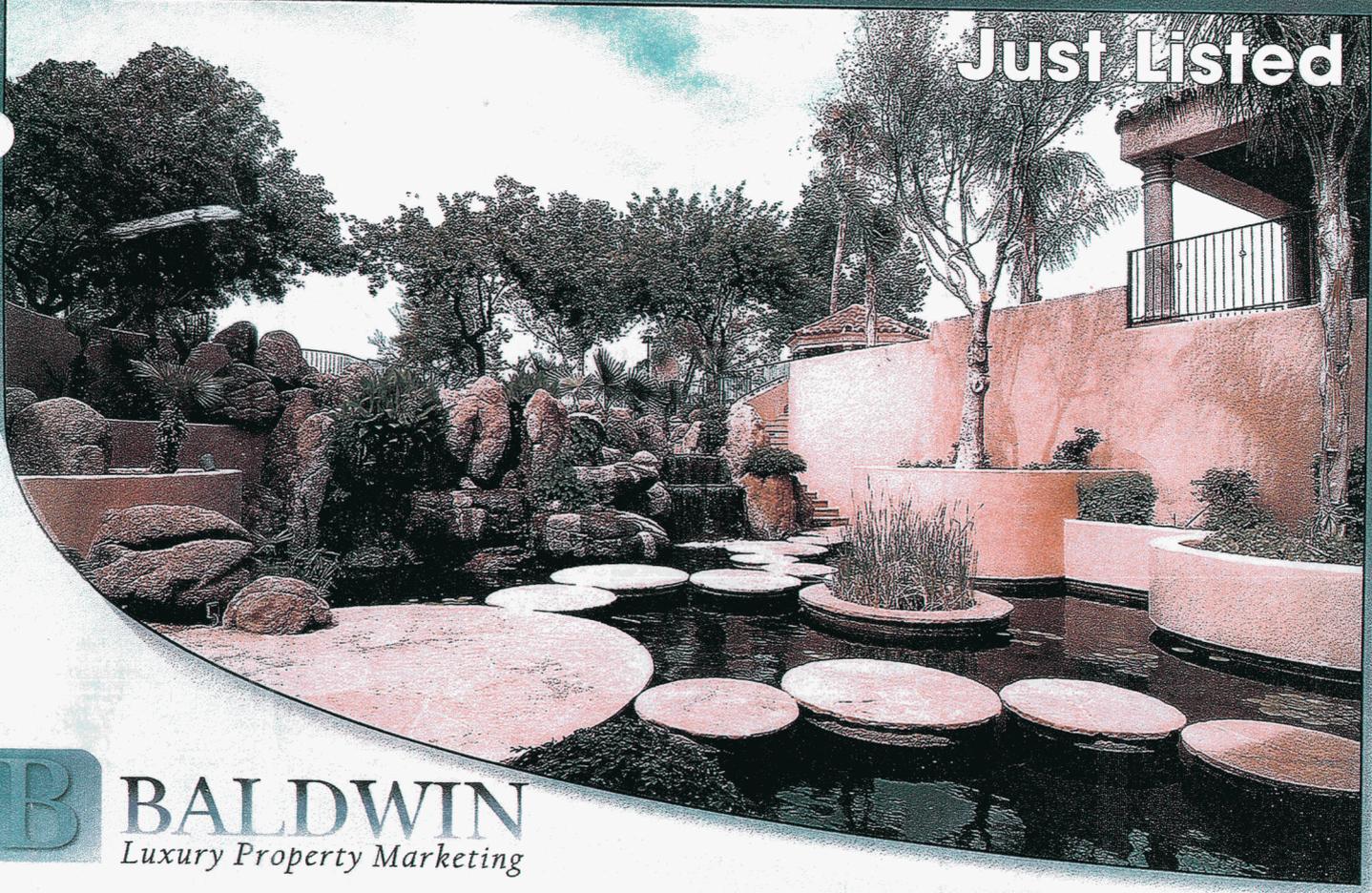
8 COMM MUNDELL: Just briefly, Mr. Chairman. We certainly had an interesting
9 discussion of the gift clause in the Constitution. And, as I said during the discussion, I actually
10 agreed with RUCO's position that was an alternative that could have been utilized by the city,
11 or the town I should say, and they chose not to go forth. What we have in front of us is a
12 reasonable alternative and I look at this a little differently. Whether we're talking about a private
13 utility or a municipality running the utility, I believe that the citizens, when we talk about reliable
14 water service, have a right to water service that provides adequate fire flow, not just reliability.
15 To me it doesn't mean just for drinking, showering and putting water in your pool and irrigating
16 it. In our society today, especially in metropolitan areas that also encompasses making sure that
17 you have adequate pressure in your fire hydrants. Again, whether it's a private company that's
18 being utilized, or a municipality-owned utility. And so, that's how I look at this issue. When
19 we talk about who's going to pay for this; well, I've heard that debate almost every Open
20 Meeting that I've been here. The people that use the system, the customers are going to pay for
21 it. And they're either going to pay for it through the rates using this mechanism or they will pay
22 for it through higher taxes through the Town of Paradise Valley, or bond election. So, they're
23 going to pay for it one way or the other, this is just one alternative that we've determined to be
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1 appropriate under these unique facts and circumstances. As I said earlier, I make a big
2 distinction between a utility executive driving around in a Lexus or Hummer versus having
3 money to pay for fire flow. So, RUCO's argument may have some merit when you're talking
4 about other types of expenses, but this is a public health and safety issue to me and I don't see a
5 distinction that should be made between the City of Phoenix having adequate water flow in areas
6 they provide water service to Paradise Valley and this private water company. I vote Aye.

7 CHMN H-M: I'll try to make this short because we have a lot more to do today. I do
8 want to say this, Arizona is changing rapidly. In areas that we're talking about, some of these
9 areas were...Ms. Leibsohn and I; I used to live where she lives now and that was rural when
10 Barry Goldwater built his house at 40th Street, just north of Camelback, he could shoot a gun out
11 any window and not hit anything because there wasn't anybody out there; just a few years ago.
12 One of our great senators. So, things are changing. More and more areas; I used to drive from
13 Phoenix to Scottsdale and enjoy the beautiful orange groves and stop off for a cool drink of
14 orange; it's not there anymore. There are islands within our city with old infrastructure in Mesa,
15 Phoenix, Scottsdale and those are going to have to be upgraded and we need to come up with a
16 way to do that. I do agree with RUCO. Let's get to the legislature; let's look at ways to fund
17 these needed infrastructures. Quite frankly, I think everybody in the state of Arizona; whether
18 you're in Payson, Show Low or here in the Valley, now see fire safety as critically important. So
19 I don't think we can ignore; public policy requires us as leaders to act. Right now, we're acting
20 in the way we can. In the future, hopefully we'll have a better system for doing so. I vote Aye.
21 By a vote of 4 ayes, 0 nays, we have approved this Order. Please go forward and improve that
22 fire safety in that community. Thank you very much.
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Mundell-2

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