ORIGINAL

0000085655

BEFORE THE ARIZONA CORPORATION CC...

RECEIVED

2008 JUN 13 A 9: 11

AZ CORP COMMISSION
DOCKET CONTROL

Arizona Corporation Commission
DOCKETED

JUN 13 2008

DOCKETED BY

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

RUCO'S CLOSING BRIEF

INTRODUCTION

The Residential Utility Consumer Office ("RUCO") submits this Brief in opposition to the proposed Rate Design Agreement ("Agreement") submitted on behalf of the Town of Paradise Valley, the Camelback Inn, the Sanctuary on Camelback Mountain and the Renaissance Scottsdale Resort (collectively the "Signatories"). RUCO supports the Arizona Corporation Commission Staff's ("Staff") proposal to provide interim relief to the Paradise Valley District's residential and resort customers by reducing the High Usage Surcharge ("HUS") from the current $2.15 per 1,000 gallons to $1.00 per 1,000 gallons. RUCO also supports Staff's recommendation to eliminate the Public Safety Surcharge ("PSS") until the Commission has the opportunity to examine the fire flow issue in the Company's next rate case proceeding. RUCO-2 at 2[1].

THE COMMISSION SHOULD REJECT THE AGREEMENT PROPOSED BY THE SIGNATORIES.

The Agreement, in relevant part, provides for the following:

1) A reduction of the existing HUS from $2.15 to $1.00 per 1,000 gallons of water sold effective March 1, 2008. The reduced HUS would recover all un-recovered fire flow improvement costs incurred up to the end of February 2008 and would continue to be booked by the Company as CIAC. T-1 at 3.

2) On March 1, 2008 the existing $1.00 per 1,000 gallons PSS would be reset to $0.00 and would subsequently be replaced with an Arsenic Cost Recovery Mechanism ("ACRM") like mechanism that would allow for regular step increases to recover the costs associated with new fire flow plant at the Commission approved 10.40 percent cost of equity. T-1 at 3.

3) The PSS would continue to apply only to the commodity portion of the rate, and the first step increase filing would likely occur in the later part of 2008 after Phase 3 of the fire flow project is completed. A charge of $0.125 per 1,000 gallons of water is estimated for the first step increase under the proposed ACRM-like mechanism. T-1 at 3.

---

[1] For ease of reference, trial exhibits will be identified similar to their identification in the Transcript of Proceedings. The Transcript page number will identify references to the Transcript.

4) For fire flow plant construction phases completed after March 1, 2008, the PSS would be designed to recover fifty percent of the investment in the improvements. The revised HUS would cover the remaining fifty percent, at least until a final order is issued by the ACC in Arizona-American's next rate case proceeding before the Commission. T-1 at 4.

5) All other rate design features of the HUS and PSS and accounting deferrals would remain in their present form until a final order is issued by the ACC in Arizona-American's next rate case proceeding. T-1 at 4.

6) During Arizona-American's next rate case proceeding, the Company will request that the proceeds from the HUS be no longer treated as CIAC, but instead be treated as an investment in plant in service that would provide the Company with a return on investment and be fully recoverable in rates. The other Signatories will join in the Company's request. T-1 at 4.

7) The Rate Design Agreement provides a timetable for the completion of Phases 3 through 7 of the fire flow improvements, but has no cost estimates for Phases 5 through 7. T-1 at 4.

RUCO opposes the Agreement for several reasons. First, the Agreement would terminate the current PSS, reset it to zero and then re-establish the PSS in ACRM-like step increase filings upon completion of each fire-flow construction phase. T-1 at 3. The ACRM-like mechanism will only consider cost increases in one category of expenses and will ignore changes in revenues, cost of capital, rate base and other expense categories. RUCO-1 at 3. Ratepayers will not enjoy the benefits of efficiencies or other potential off-sets to costs since the sole focus of the step reviews will be the incremental fire flow construction costs. This is "single-issue" ratemaking and is "fraught with potential abuse." See *Scates v. Arizona Corporation Commission*, 118 AZ. 531, 534, 578 P.2d 612, 615 (1978). To the extent the

Commission is willing to consider such mechanisms, it should only do so under the most dire and extreme circumstances. Approving a mechanism for the recovery of discretionary projects that are not in the purview of what the Commission regulates does not qualify for this extraordinary ratemaking device.

The ACRM was the result of a change in the federal law which did not provide water companies with an alternative. No one questioned that to comply with the new federal arsenic standard, numerous water utilities would have to expend large amounts of capital in a relatively short time to build the infrastructure. In addition, there would be operation and maintenance costs. RUCO, Staff and the water utilities all understood the unique situation confronting the water utilities because of the new law, and worked hard to come up with a cost recovery mechanism that was fair to ratepayers and allowed timely cost recovery. While the ACRM raises the same concerns addressed by the *Scates* decision, the mechanism became unavoidable given the federal mandate and its simultaneous impact on a large number of Arizona water systems.

Here, the Signatories are proposing a similar mechanism be applied to remedy biased rates that are currently being paid by certain classes of ratepayers (high-end users). These same ratepayers advocated for the fire flow construction in the underlying case. These ratepayers knew the estimated costs of the construction, and that the costs would be recovered through rates. The situation here is not the same as the case with the Arsenic Cost Recovery Mechanism, and the Commission should not disregard tried and proven ratemaking principles in an effort to provide a group of ratepayers short-term relief from something that they originally advocated for.

Second, the step increases will fund future rate hikes that have no definite cost at this time. RUCO-1 at 9. Paragraph III (G) of the Agreement sets forth the current construction schedule for the fire flow projects. T-1 at 4. The estimated costs for Phases 5, 6, 7 are "TBD". The entire project was estimated at $16.1 million. Transcript at 315. The final estimate now is unknown but "it's significantly higher" than the $16.1 million estimate. Transcript at 96. The Commission's approval of the Agreement with an ACRM-like mechanism that allows for an unspecified number of step-increases to recover an undetermined amount of costs could well be the same as handing a blank check to the Company. RUCO-1 at 10.

Third, the Agreement is ambiguous, and should not be approved. RUCO has stated clearly that all things being equal, it would consider a modification to the rate design that holds classes not otherwise adversely affected by the current rate design harmless (i.e. customers that are not high-end users). However, RUCO would oppose any modification of the current rate design that shifts the costs from the high-end users to the low-end users. The proposed ACRM-like mechanism will recover the fire flow construction costs through step-increases. The Agreement is silent on which ratepayers will be paying for the increases. In the past, where the Commission has approved an ACRM, the step-increases have always applied to all the ratepayers in the affected district. If the ACRM-like mechanism is allocated in this manner, it would shift the costs from the high-end users to the low-end users. However, the Agreement does not define how the ACRM-like mechanism would be allocated to end-users. At the hearing in this matter, the expert witness for the Resorts (the Camelback Inn, the Sanctuary on Camelback Mountain and the Renaissance Scottsdale Resort), John Thornton, testified that the modified PSS surcharge will be recovered only from "those blocks where the current PSS applies." Transcript at 240. During cross-examination, Mr. Thornton explained that the signatories' intention to apply the modified PSS to the same blocks that the current PSS applies, is memorialized in paragraph III (E) of the Agreement. Transcript at 240-242. Paragraph III (E) of the Agreement provides as follows:

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

Regardless of the intent of the signatories, nowhere in the Agreement, including paragraph III (E) do the signatories specify which ratepayers will be paying the step-increases. It is subject to interpretation, and for this reason the Agreement is ambiguous and should be rejected.

Finally, it is not appropriate to treat the proceeds of the HUS as revenue, because they are ratepayer-supplied funds provided for the purpose of funding fire-flow plant. RUCO-1 at 12. Since these funds are not being provided by Arizona-American's investors, it would be unfair for the Company to earn a rate of return on them. Id. The Commission should reject the Agreement's proposal to allow the Company to earn a return on HUS proceeds after the next rate case.

CONCLUSION

The Commission should reject the Agreement. The Commission should approve Staff's recommendation to provide interim relief to the Paradise Valley District's residential and resort customers by reducing the HUS from the current $2.15 per 1,000 gallons to $1.00 per 1,000 gallons, and to eliminate the PSS until the Commission has the opportunity to examine the fire flow issue in the Company's next rate case proceeding.

RESPECTFULLY SUBMITTED this 13th day of June 2008.

Daniel Pozefsky
Attorney

AN ORIGINAL AND THIRTEEN COPIES
of the foregoing filed this 13th day
of June 2008 with:

Docket Control
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

COPIES of the foregoing hand delivered/
mailed or emailed this 13th day of June 2008 to:

Teena Wolfe
Administrative Law Judge
Hearing Division
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

Janice Allward, Chief Counsel
Legal Division
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

Ernest Johnson, Director
Utilities Division
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

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

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

Robert J. Metli
Snell & Wilmer L.L.P.
One Arizona Center
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
Ernestine Gamble