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BEFORE THE ARIZONA CORPORATION COMMISSION

- 2 KRISTIN K. MAYES
CHAIRMAN
- 3 GARY PIERCE
COMMISSIONER
- 4 SANDRA D. KENNEDY
COMMISSIONER
- 5 PAUL NEWMAN
COMMISSIONER
- 6 BOB STUMP
COMMISSIONER

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Arizona Corporation Commission
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FEB 13 2009

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7
8 IN THE MATTER OF THE APPLICATION OF
9 CHAPARRAL CITY WATER COMPANY,
10 INC., AN ARIZONA CORPORATION, FOR A
11 DETERMINATION OF THE FAIR VALUE OF
ITS UTILITY PLANT AND PROPERTY AND
FOR INCREASES IN ITS RATES AND
CHARGES FOR UTILITY SERVICE BASED
THEREON.

Docket No. W-02113A-07-0551

RUCO'S REPLY BRIEF

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13 The Residential Utility Consumer Office ("RUCO") submits its Reply Brief on the matters
14 raised at Chaparral Water Company's ("Chaparral" or the "Company") recent rate hearing.

- 15 1. **CURRENT RATEPAYERS SHOULD NOT HAVE TO PAY FOR THE CAP**
- 16 **WATER ALLOCATION IF THE PURPOSE OF THE ALLOCATION IS FOR**
- 17 **DEVELOPMENT OF A SUBDIVISION ON STATE TRUST LANDS.**

18 The Company asserts that it *needs* 100% of the water allowance to serve its customers
19 and provide a drought buffer in the event of future curtailments in CAP water. The Company
20 does not need the water to satisfy the demands of its current customers. In Decision 68238,
21 the Staff indicated, "Chaparral City has sufficient source and storage capacity to serve up to
22 18,000 customers".¹ In 2007, the Company had 13,347 customers.² The Company has held a
100-year Assured Water Supply Designation since the mid-1980s.³

24 ¹ See Decision 68238, Chaparral's Application for Extension of Certificate of Convenience and Necessity dated
October 25, 2005, Docket No. W-02113A-05-0178

1 Staff's engineer, Marlin Scott, testified that the Company *wants* the additional CAP
2 allocation so that it can expand its CC& N.⁴ The Company seeks to extend its CC&N to include
3 approximately 1,300 acres of state trust land located north of the Town of Fountain Hills and
4 immediately adjacent to Chaparral City's existing CC&N area.⁵ The purpose of the extension is
5 to provide an assured water supply to permit the sale of the land to a private subdivision
6 developer.⁶ In order to develop a subdivision on the land around Fountain Hills, the developer
7 needs a 100-assured water supply.⁷ As reflected in Decision No. 68238:

8 *Chaparral City's service area is located within the Phoenix Active Management Area*
9 *("AMA") and a developer in the extension area would therefore be required by the*
10 *Arizona Department of Water Resources ("ADWR") to demonstrate a 100-year*
11 *assured water supply prior to recording plats or selling parcels.*

12 *A developer may prove a 100-year supply by satisfying the ADWR*
13 *requirements for a Certificate of Assured Water Supply, or by a written commitment of*
14 *service from a provider with a Designation of Assured Water Supply ("Designation")*
15 *for its existing service area. Chaparral City holds a Designation for its existing CC&N*
16 *area and Staff expects that the Company will seek to amend its Designation to include*
17 *the extension area.*⁸

18 The Company and Staff propose to book 100% of the additional CAP allocation as land
19 and land rights, a non-depreciable account, and permit the Company to earn a return thereon
20 in perpetuity. If approved, the Company's and Staff's recommendation would allow the
21 Company to expand its service area for the benefit of the State Land Department or a
22 developer at the expense of current ratepayers. RUCO objects to the current ratepayers
23 paying the expense for future development.

24 ² See Exhibit R-2, ADWR Report dated August 25, 2008
³ T: 124, 130 and Exhibit R-3 ADWR Report
⁴ T: 337, II.1-8 and Decision No. 68238 issued October 25, 2005
⁵ *Id.* at 1.
⁶ *Id.* at 3 at footnote 2.
⁷ *Id.* at 4
⁸ *Id.* at 4.

1 If the additional CAP allocation is for a CC&N extension, which allows the State Land
2 Department to achieve a higher sales price on the land, all taxpayers would benefit.
3 Therefore, all taxpayers, not just Chaparral's current taxpayers, should bear the cost. If,
4 however, the purpose of the additional CAP allocation is to benefit a developer, the costs
5 should fall upon the developer. If the Commission adopts the position suggested by Staff and
6 the Company, Chaparral's ratepayers will bear the full cost of the additional CAP allocation
7 while the true beneficiaries, the subdivision developer and/or the State, receive the benefit. In
8 addition, the Company will be permitted to expand its CC&N and therefore its future rate base
9 at the expense of current ratepayers. Neither scenario represents fair or reasonable
10 ratemaking. RUCO recommends that the Commission reject the Company's and Staff's
11 position and disallow the additional CAP allocation.

12 **2. IF THE CAP ALLOCATION IS FOR A DROUGHT BUFFER CURRENT**
13 **RATEPAYERS SHOULD ONLY HAVE TO PAY FOR THAT PORTION WHICH**
14 **IS USED AND USEFUL.**

15 Staff recommended 100% of the additional CAP allocation be treated as land and land
16 rights in a non-depreciable account.⁹ Staff's recommendation would disallow amortization
17 expense, but permit the Company to recover one-half of the annual water service capital
18 charge and provide a return on rate base in perpetuity.¹⁰ Staff based its conclusion upon the
19 opinion of its engineer, Mr. Scott. In its Closing Brief, Staff asserts Mr. Scott's determination of
20 what portion of the additional allocation would be used and useful was an engineering opinion
21 and therefore ostensibly, the most accurate.¹¹ RUCO disagrees. Although Mr. Scott is an
22 engineer, his opinion was not based on engineering principles. Mr. Scott testified he based his

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24 ⁹ T: 56-57.

¹⁰ T: 338

1 opinion wholly on the Company's annual report submitted to the Commission.¹² Based on the
2 annual reports, he concluded that the Company had 13,345 customers in 2006 and projected
3 the company would have 15,350 customer accounts by 2012.¹³ Based on the projection of
4 15,350 new accounts, Mr. Scott projected 966 acre-feet or 50% of the additional CAP
5 allocation would be used and useful by the year 2012.¹⁴

6 To reach Mr. Scott's 2012 projection, the Company would have to establish 334 new
7 accounts per year from 2007 through 2012.¹⁵ Mr. Scott rendered his opinion without
8 consideration of the current economic circumstances in Fountain Hills or the Company's
9 annual report to the Arizona Department of Water Resources ("ADWR"), which discloses the
10 Company's actual new accounts.¹⁶ In August 2008, the Company submitted its 2007 annual
11 report to the ADWR disclosing 13,347 customer accounts or exactly 2 new accounts as of July
12 1, 2007.¹⁷ During the public comment, Fountain Hills' Mayor, Jay Schlum, stated that the rate
13 increase as proposed would have an adverse effect on the community and that the Town of
14 Fountain Hills had issued zero single-family home permits in this fiscal year.¹⁸ It is clear,
15 based on the Company's new account generation and the current economic circumstances,
16 Mr. Scott's mathematical projections should be rejected as a basis for determining what
17 amount of the CAP allocation is used and useful.

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20 ¹¹ See Staff's Closing Brief at p.22.

¹² See Exhibit S-1, Direct Testimony of Marlin Scott at 5.

¹³ *Id.*

¹⁴ Mr. Scott's estimates for average use per lot are inconsistent with the figures reported by the Company in its ADWR report. See also Exhibit R-2 2007 ADWR report. The Company indicates the average consumption per residential lot is .359 acre-feet/year/lot. Even assuming the Company acquired 2005 new accounts by 2012, the used and useful portion would be 719 acre-feet, using the Company's. The Company estimates need of an additional 441 acre-feet/year by 2012($27,388 - 25,391 = 2,507 / 2.04 = 1229 \times .359 = 441$ additional acre feet by 2012).

¹⁵ $15,350 - 13,345 = 2,005 / 6 = 334.16$

¹⁶ See Exhibit S-1, Direct Testimony of Marlin Scott at 5.

¹⁷ See Exhibit R-2, ADWR Report dated August 25, 2008.

¹⁸ *Id.*

1 The Company's estimates, provided by Robert Hanford, the Company's District
2 Manager, do not support its recommendation to place 100% of the additional CAP water in rate
3 base as a regulatory asset. Mr. Hanford testified that Chaparral has held a certificate of
4 assurance of 100-year assured water supply designation within an active management area
5 since the mid-80's.¹⁹ Mr. Hanford further estimated that the demand in 2010 would be an
6 additional 351 acre-feet based on 987 new accounts.²⁰ Mr. Hanford estimated that the
7 additional demand in 2016 would be 607 acre-feet based on 1,692 new accounts.²¹

8 Mr. Hanford's calculations do not reflect actual accounts as reported by ADWR or the
9 current economic circumstances i.e. zero growth, revealed by Mayor Schlum. Nonetheless, by
10 Mr. Hanford's optimistic estimates, 18.17% of the additional CAP allocation will be needed by
11 2010 and 31.43% by 2016.²² Mr. Hanford's calculation that 70% to 80% of the additional CAP
12 allocation will *not* be used and useful by 2016 undermines the Company's recommendation
13 that the Commission book the 100% of the additional CAP allocation in a non-depreciable
14 account.

15 Another issue is whether the Company's lost or unaccounted water provides an
16 adequate drought buffer. Lost or unaccounted water is that amount of water the Company has
17 received from CAP or pumped sources, but has not delivered to its customers. Lost or
18 unaccounted water is also referred to as non-account water or water loss. Mr. Scott testified
19 that the industry standard for non-account water is 10%.²³ Mr. Scott and Mr. Hanford testified
20 that lost or unaccounted water has been a continuing issue since before September 2005.²⁴

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23 ¹⁹ T: 124, 130 and See also Exhibit R-2, ADWR Report dated August 25, 2008.

²⁰ T: 83, ll.17-23.

²¹ T: 83-84, ll. 23-17

²² Id.

²³ T: 330

²⁴ T: 66, ll.1-7, T: 330

1 Mr. Scott testified that in the Company's prior case the water loss was 11.6%.²⁵ Mr. Scott
2 testified that the Company experienced approximately 1200 acre-feet of lost or unaccounted
3 water in 2006 or 15.9% of the water received.²⁶ In 2007, the Company reported
4 lost/unaccounted water of 1,030 acre-feet of water or a loss of water that exceeds 14%.²⁷ The
5 Company and Staff testified that the water was not lost due to leaks, broken mains or
6 maintenance issues, but as a result of metering inaccuracies either at the homes of ratepayers
7 or at the CAP canal.²⁸ Currently, if the Company accounted for the water in excess of the
8 acceptable loss standard (10%), the Company would have an additional 4% or 315.5-plus
9 acre-feet available to satisfy the needs of its customers.²⁹ If the Company accounted for
10 unaccounted water there would be no need for additional CAP allocation for drought buffer.

11 In its Closing Brief, Staff claimed that the Company needs the additional CAP allocation
12 because the current CAP allocation was exceeded in 2006.³⁰ Staff's argument is not
13 compelling. If the Company exceeded its CAP allocation because it had lost and unaccounted
14 water of 15.9%, the Company needs to resolve its lost and unaccounted water problem.³¹

15 Mr. Hanford indicates that the Company intends to file for rate relief again within 2-3
16 years.³² Given that the Company intends to file again in 2-3 years, it is not imperative that the
17 Commission adopts the Company's position and include 100% of the additional CAP allocation
18 in a non-depreciating account, permitting the Company a return in perpetuity.

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21 ²⁵ T: 330, See also Decision 68176

22 ²⁶ T: 307, ll. 14-19, 329

23 ²⁷ T: 62. Percentage of water loss= 1,030 acre-feet lost /7,145 acre-feet received = .144156 x100 = 14.4156%

24 ²⁸ T: 67, 320

²⁹ Water in excess of 10% acceptable water loss std. = 1,030 acre-feet lost - (7,145 acre-feet received x 10%) = 1,030 acre-feet - 714.5 acre-feet = 315.5 acre-feet

³⁰ See Staff's Closing Brief at.4.

³¹ T: 307, ll. 14-19, 329

³² T: 121, ll. 1-13.

1 If the Commission determines that some measure of the additional CAP allocation is
2 needed for a drought buffer, RUCO requests the Commission consider the absence of growth
3 and the Company's continuing lost water and include only that measure of additional CAP
4 allocation, which is used and useful. RUCO originally recommended 50% of the additional
5 CAP allocation. However, after consideration of ADWR report, Mayor Schlum's update on
6 current zero growth and the revelation of a continuing issue with non-account water, Tim
7 Coley, RUCO's analyst, determined that less than 50% of the CAP allocation was used and
8 useful.³³ RUCO determined that the used and useful portion was in the single digit
9 percentages.³⁴ Accordingly, RUCO's revised recommendation is that no more than 35% of
10 the additional CAP allocation be treated as land and land rights in a non-depreciable account.
11 Further, RUCO agrees with the Staff recommendation to disallow amortization expense.

12 3. M&I CHARGES ASSOCIATED WITH CAP ALLOCATION

13 Staff recommends that the Company be permitted to recover 50% of its annual water
14 service capital charge. As stated previously, RUCO asserts that the Company's water
15 supplies are sufficient to meet its current and future demand and that if the Company needs a
16 drought buffer, it work more diligently to resolve its long-standing water loss issue. If the
17 Company's true motivation is to acquire additional water to achieve expansion of its CC&N, for
18 the development of State Trust lands by the State and/or a subdivision developer, RUCO
19 asserts that all beneficiaries of the allocation should pay an equitable share. If, however, the
20 Commission determines in its discretion that some portion of the additional CAP water is used
21 and useful to the ratepayers, RUCO believes that a commensurate portion of the annual water
22 service capital charge associated therewith be included as an M & I Expense.

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24 ³³ T: 301

³⁴ *Id.*

1 **4. DISTRIBUTION OF THE SETTLEMENT PROCEEDS FROM FOUNTAIN**
2 **HILLS SANITATION DISTRICT**

3 RUCO asserts that the settlement proceeds for the contamination of Wells 8 & 9 be
4 allocated 100% to the ratepayers. The Company argues that RUCO's position is based on a
5 mistaken belief that ratepayers own the Company's assets.³⁵ RUCO has not based its
6 assertion on the belief that ratepayers own Wells 8 and 9. RUCO's position is based on the
7 law and the facts. A public utility that is efficiently and economically managed is entitled to
8 recover the cost of its investment and a reasonable return thereon.³⁶ Robert Hanford, the
9 Company's district manager, testified that:

10 *...both wells were constructed over 36 years ago and have been fully depreciated and*
11 *have no impact on rate base in the instant case.*³⁷

12 By its own admission, the Company has fully recovered the cost of Wells 8 and 9 and received
13 a reasonable return thereon. By law, the Company is entitled to no more.

14 The Company complains that Well 8 was not used for potable water and therefore the
15 ratepayers should not be able to recover the portion of the settlement associated with Well 8.
16 The Company's argument is disingenuous. Mr. Hanford testified that the purpose of the
17 settlement was to replace water Well 9 would produce over the remainder of its useful life.³⁸
18 Given that ratepayers will have to pay 100% of the cost of replacement water from Well 9, they
19 should be able to apply 100% of the settlement proceeds to the expense of replacement water.

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23 ³⁵ Company's Closing Brief at 9.

24 ³⁶ Bluefield Water Works & Improvement Co. v. Public Service Commission of West Virginia, 262 U.S. 679(1923)
and Federal Power Commission v. Hope Natural Gas Company 320 U.S. 391(1944)

³⁷ T: 255-278, 416-417. See also Exhibit S-2 at 13 and Exhibit R-10 MEM DR 7.3.

³⁸ T: 100, 416-417. See also Exhibit A-1, Hanford's Direct Testimony, p. 10, ll. 11-13, Exhibit S-2, Millsap's
Direct Testimony at 13.

1 The Company complains that the settlement proceeds should be distributed 50/50
2 consistent with Decision No. 66849.³⁹ The facts of this case are distinguishable from Decision
3 No. 66849. First, in Decision No. 66849, Arizona Water received replacement water and wells.
4 Second, there is no evidence in Decision No. 66849 that the Company fully recuperated its
5 investment of and on the contaminated wells. Here, the Company admits Wells 8 and 9 are
6 fully depreciated and that the Company received its return of and on its investment. Here the
7 Company did not receive replacement wells and water. Accordingly, this case is easily
8 distinguishable from Decision No. 66849, the Company's argument has no merit and should be
9 rejected.

10 The Company argues that a failure to provide it with 50% of the proceeds will serve as a
11 disincentive for utilities to spend legal fees to pursue legal remedies if they are not allowed to
12 share in the recovery. The Company may be able to share in the recovery in some
13 instances.⁴⁰ The Company testified that the legal expense associated with the settlement of
14 the dispute was \$20-\$40,000 dollars.⁴¹ If so, RUCO has no objection to the Company
15 recovering the legal expense associated therewith. RUCO disagrees that the Company is
16 entitled to anything more in light of the fact that the Company has fully recovered its
17 investment in the wells and a reasonable return thereon. RUCO recommends that the
18 Commission require the \$1.52 million settlement be distributed to ratepayers minus the legal
19 fees associated therewith.

20 The Company asserts that Staff changed its position and that RUCO stands alone in its
21 position.⁴² Simply stated, even if true, who cares? Staff proffered one witness on the issue of
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23 ³⁹ See Decision No. 66849, Arizona Water Eastern Group dated March 19, 2004, Docket No. W-01445A-02-0619.

24 ⁴⁰ *Id.*

⁴¹ T: 141

⁴² See Company Closing Brief at 8.

1 the FHSD settlement proceeds, Marvin Milsap, a certified public accountant.⁴³ Mr. Milsap
2 testified in direct and on surrebuttal that the compensation for Wells 8 and 9 should not be
3 shared 50/50 between shareholders and ratepayers.⁴⁴ He correctly pointed out that the assets
4 are fully depreciated; the shareholders have already recovered the full cost of their investment
5 through depreciation expense and received a full return on their investment.⁴⁵ Shareholders
6 are entitled to no more under the law.

7 During the course of the hearing, Mr. Milsap indicated that Staff withdrew its objection to
8 the Company's treatment of the settlement proceeds. However, Staff offered no rationale for
9 its position that the Company should receive 50% of the proceeds. Staff's sole witness, Mr.
10 Milsap testified that the settlement proceeds should be distributed 100% to the ratepayers and
11 he did not change his position or testimony.⁴⁶ He further testified that he did not analyze the
12 need for the change of position and that no one on Staff provided him with information to
13 support the change in position.⁴⁷ In the absence of testimony or evidence to support the
14 rationale for the change in position, the Commission should reject Staff's current position.

15 In its Closing Brief, for the first time, Staff explains its change in position: "based on the
16 Company's willingness to share any future proceeds gained through the sale and after
17 extensive additional testimony, it has revised its position." The Company's agreement to share
18 the proceeds from the sale of the Wells is a red herring. The Company testified that the Wells
19 have no or nominal value.⁴⁸ The notion that the Company is willing to split nominally valued
20 wells for a 50% share of \$1.52 million should not be a basis for the Commission to deny

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22 ⁴³ See Exhibit S-2 Milsap Direct Testimony at 5-6 and 11-15. See also Exhibit S-3 Milsap Surrebuttal Testimony
at 3-4.

23 ⁴⁴ See Exhibit S-2 at 5-6, 11-15.

24 ⁴⁵ T: 416-417. See also Exhibit S-2 Milsap Direct Testimony at 13. See also, R-10 MEM DR 7.3.

⁴⁶ T: 416-417,

⁴⁷ *Id.*

⁴⁸ See Exhibit A-2 Hanford Rebuttal Testimony at 3-4.

1 ratepayers the money necessary to pay for replacement water. The evidence does not
2 support Staff's revised position and the Commission should reject it.

3 **3. Rate Case Expense**

4 RUCO addressed all of the issues raised in the Company's Closing Brief and has
5 nothing further to add.

6 **4. Computation of Property Tax Expense**

7 RUCO addressed all of the issues raised in the Company's Closing Brief and has
8 nothing further to add.

9 **5. Computation of Amortization of Contributions in Aid of Construction**

10 RUCO addressed all of the issues raised in the Company's Closing Brief and has
11 nothing further to add.

12 **CONCLUSION**

13 RUCO disagrees that 100% of the additional CAP water allocation should be
14 booked in a non-depreciating account permitting the Company to earn a return thereon in
15 perpetuity, or that the Company should be permitted to recover 50% of its annual water service
16 capital charge. If the Company's true motivation is to acquire additional water to achieve
17 expansion of its CC&N, RUCO asserts that the expense of the additional allocation fall on the
18 beneficiaries, the State and/or the subdivision developer. RUCO asserts that the Company's
19 water supplies are sufficient to meet its current demand and that if the Company needs a
20 drought buffer, it work more diligently to resolve its long-standing water loss issue. If in its
21 discretion, the Commission determines some amount of the additional CAP allocation is
22 needed as a drought buffer, RUCO recommends no more than 35% given the absence of
23 growth and the long standing water loss issue.
24

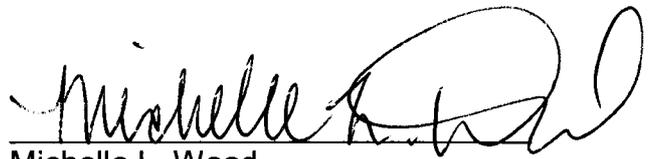
1 RUCO disagrees that the FHSD settlement proceeds should be divided equally
2 between shareholders and ratepayers. Shareholders have received recovery of and on their
3 investment in Wells 8 and 9 and are legally entitled to no more.

4 RUCO asserts that the Company's request for legal fees for the appeal and remand be
5 denied as a matter of law and public policy.

6 RUCO requests that the Commission consider and adopt an alternative method of
7 computing property tax expense to avoid the excessive \$300,000 overpayment from 2006-
8 2007. RUCO requests the Commission adopt ADOR methodology of averaging three
9 historical years or RUCO's new alternative of adding the last known and measurable property
10 tax expense and the property tax expense associated with the additional increment of adjusted
11 proposed revenue approved by the Commission.

12 Last, RUCO requests that the Commission deny the Company's attempt to amortize
13 CIAC using a composite amortization rate based on all accounts. RUCO suggests the
14 Company be required to utilize the amortization rate established in the prior case or a rate
15 established based on CIAC amounts and the corresponding plant depreciation rates to insure
16 that plant and CIAC are properly matched.

17 RESPECTFULLY SUBMITTED this 13th day of February 2009.

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20 Michelle L. Wood
21 Counsel

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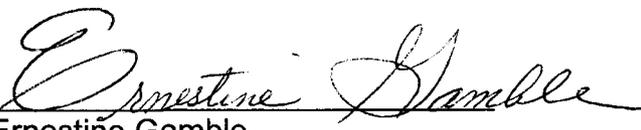
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