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BEFORE THE ARIZONA CORPORATION COMMISSION

05

COMMISSIONERS

KRISTIN K. MAYES, Chairman  
GARY PIERCE  
SANDRA D. KENNEDY  
PAUL NEWMAN  
BOB STUMP

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 AGUA FRIA WATER DISTRICT, HAVASU WATER DISTRICT, MOHAVE WATER DISTRICT, PARADISE VALLEY WATER DISTRICT, SUN CITY WEST WATER DISTRICT, AND TUBAC WATER DISTRICT.

DOCKET NO. W-01303A-08-0227

Arizona Corporation Commission  
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IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY, AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE CURRENT FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES BASED THEREON FOR UTILITY SERVICE BY ITS MOHAVE WASTEWATER DISTRICT.

DOCKET NO. SW- 01303A-08-0227

**NOTICE OF FILING  
POST-HEARING BRIEF**

1 Arizona-American Water Company hereby files its post-hearing brief in the above-  
2 captioned dockets.

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RESPECTFULLY SUBMITTED on May 1, 2009.

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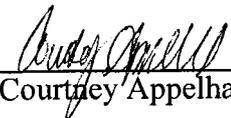
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**POST-HEARING BRIEF OF ARIZONA-AMERICAN WATER COMPANY**

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**I     INTRODUCTION**

1           There is no way to sugarcoat Arizona-American’s poor financial condition.<sup>1</sup> Arizona-  
2 American’s operating districts have under-earned for several years and Arizona-American, as a  
3 whole, has lost over \$30 million since American Water purchased the assets of Citizens Water  
4 Resources (“Citizens”) in 2002. This unfortunate trend continues. Arizona-American again had  
5 a net income loss of \$4.6 million in 2007 and \$1.8 million in 2008 and expects to continue to  
6 operate at a loss in 2009. Losses may continue into 2010 depending on the amount of new rates  
7 approved in this case.

8           Arizona-American’s current financial condition can be attributed to at least three factors.<sup>2</sup>  
9 First, in Decision No. 65453, dated December 12, 2002, the Commission imposed a moratorium  
10 on filing rate case applications from January 2003 until January 2006. This largely prevented  
11 Arizona-American from timely including capital investments in ratebase and from recovering  
12 increased operating expenses.

13           Second, Decision No. 63584 included a provision that assets purchased from Citizens  
14 would not be immediately included in rate base, but would instead be amortized into rate-base  
15 over a period ranging from six and one-half years to ten years.<sup>3</sup> Despite the resulting delay in  
16 recognizing these assets in its rates, Arizona-American had agreed to this condition with Staff,  
17 based on a one-year not three-year rate filing moratorium. When a year later the Commission-  
18 imposed a three-year rate case filing moratorium, it meant that Arizona-American could only  
19 begin to recover these assets after the moratorium expired, new rate cases were filed, and the

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<sup>1</sup> This paragraph, Exhibit A-18 at 4-9 (updated).

<sup>2</sup> This Paragraph, Exhibit A-19 at 3:21 – 4:2.

<sup>3</sup> This Paragraph, Exhibit A-19 at 4:3-13.

1 Commission approved recovery. The first case to approve recovery of any portion of the  
2 amortizations was Decision No. 69440, dated May 1, 2007, for the Mohave Water and  
3 Wastewater Districts. As of April 30, 2008, Arizona-American had been authorized rate  
4 recovery for only \$25 million of the total \$125 million of imputed regulatory AIAC and CIAC.

5 Third, the nature of historic test years in Arizona automatically causes a lag between the  
6 date a company expends capital and the date that the company starts to earn a return on and of  
7 that capital. This is a particular issue for companies like Arizona-American that must invest to  
8 meet the needs of its customers in fast growing areas like Maricopa and Mohave Counties.<sup>4</sup>

9 Arizona-American has been able to make all the necessary capital investment in Arizona  
10 only because of its parent's (American Water) willingness to infuse new equity and make long-  
11 term borrowing at a very attractive rate to Arizona-American.<sup>5</sup> It is not known how much longer  
12 Arizona-American's access to capital from or through its parent will continue if Arizona-  
13 American continues to suffer net losses. Without American Water's financial commitment to  
14 Arizona-American, Arizona-American could face the threat of financial restructuring or capital  
15 restrictions if its financial condition does not improve soon.

16 Arizona-American has not paid a dividend to American Water since 2002. Despite this  
17 and Arizona-American's continuing poor financial performance, American Water infused \$35  
18 million of equity in 2006, \$15 million more in 2007, and another \$20 million in 2008.<sup>6</sup> No more  
19 equity infusions are planned.<sup>7</sup>

20 Continuing financial losses and resulting actions by management impact not only  
21 Arizona-American's shareholder, but also its customers.<sup>8</sup> Because of diminished returns to the  
22 shareholder, there is diminished investment in Arizona-American, diminished staffing, and  
23 diminished spending.

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<sup>4</sup> This Paragraph, Exhibit A-19 at 4:14-18.

<sup>5</sup> This Paragraph, Exhibit A-18 at 5:13-19.

<sup>6</sup> This Paragraph, Exhibit A-18 at 5:22 – 6-5 (updated).

<sup>7</sup> Exhibit A-19 at 2:15-17.

<sup>8</sup> This Paragraph, Exhibit A-19 at 2:3-7.

1 In addition to suspending dividends to its parent, Arizona-American has cut its planned  
 2 capital expenditures over the next five years by almost fifty percent.<sup>9</sup> Over \$92.5 million of  
 3 specific Company-funded capital projects have been either deferred or eliminated, which  
 4 represents a 46% reduction from Arizona-American's previous capital plan.

5 For 2009 and beyond, Arizona-American is reducing staff positions by 25, which  
 6 represent \$1.1 million in gross salary dollar savings. These position reductions come from the  
 7 deferral or elimination of planned positions and the consolidation of existing positions as  
 8 vacancies occur. Management has also examined all costs in the business and has reduced its  
 9 budget for controllable costs compared to its previous plan for a variety of measures including  
 10 reductions in office expenses, reductions in telecommunication expenses, reductions in training  
 11 and travel expenses, elimination of all business-development costs, reductions or deferral of  
 12 certain maintenance expenses, and other items.<sup>10</sup>

13 Timely and adequate rate relief is critical for Arizona-American to maintain its present  
 14 service quality and to continue investing in projects needed by its customers.

15 **II ARIZONA-AMERICAN'S CASE**

16 Arizona-American presented its case through the testimony and exhibits of thirteen  
 17 witnesses:

	<b>Name</b>	<b>Subject Matter</b>	<b>Exhibits</b>	<b>Transcript</b>
1	Paul G. Townsley: Arizona-American President	Mr. Townsley testifies that:  1. Arizona-American's current financial condition continues to be poor - timely and adequate rate relief from the Commission is necessary  2. Management is undertaking a number of actions to improve financial	A-18, A-19	

<sup>9</sup> This Paragraph, Exhibit A-19 2:21-23.

<sup>10</sup> This Paragraph, Exhibit A-19 at 3:5-13..

		<p>performance by reducing costs, staffing, and capital expenditures.</p> <ol style="list-style-type: none"> <li>3. Arizona-American's Achievement Incentive Pay benefits our customers.</li> <li>4. It is reasonable to establish a deferral account for O&amp;M costs for the White Tanks Plant.</li> <li>5. It is also appropriate to include a portion of the Plant's construction work in progress in rate base.</li> <li>6. Staff and RUCO recommendations regarding the White Tanks Water Treatment Plant and the Wishing Well Wastewater Treatment Plant will cause harm to Arizona-American and should be rejected.</li> <li>7. There are long-term benefits to customers of consolidation for ratemaking purposes between Arizona-American districts, as long as consolidation does not cause further financial harm to the Company.</li> </ol>		
2	<p>Christopher C. Buls: Arizona-American, Vice President of Finance</p>	<p>Mr. Buls testifies that:</p> <ol style="list-style-type: none"> <li>1. It made sense originally to finance the White Tanks Plant with hook-up fees, but now, with the precipitous decline in housing starts, the plant can no longer be financed with</li> </ol>	A-20	

		<p>hook-up fees alone.</p> <ol style="list-style-type: none"> <li>2. Authorizing \$25 million of CWIP in rate base will mitigate the problem, but will not provide a full solution.</li> <li>3. Arizona-American cannot carry the cost of this project on hook-up fees alone. If the results of this rate case are disappointing, Arizona-American must consider mothballing or selling the facility.</li> </ol>		
3	G. Troy Day: Arizona-American, Vice President of Operations	<p>Mr. Day:</p> <ol style="list-style-type: none"> <li>1. Supports proposed tank-maintenance program.</li> <li>2. Supports program to replace water meters every 15 years.</li> </ol>	A-10, A-38	
4	Joseph E. Gross: Arizona-American, Engineering Director	<p>Mr. Gross:</p> <ol style="list-style-type: none"> <li>1. Discusses a number of recently completed capital projects including the upgrade and expansion of the Wishing Well Wastewater Treatment Facility in the Mohave Wastewater District.</li> <li>2. Provides a status report on the White Tanks Plant and the extreme slowdown in customer growth in the Agua Fria Water District.</li> <li>3. Discusses Arizona-American's plans to build an arsenic-treatment facility for the Tubac Water District.</li> </ol>	A-1 through A-5	

		<p>4. Explains that the Wishing Well Plant construction was largely required to bring the facility up to rated capacity and that the capacity expansion was in accordance with Commission, ADEQ, and prudent engineering standards.</p> <p>5. Explains that the Company's arsenic-treatment facilities were appropriately sized</p>		
5	Thomas M. Broderick: Arizona-American, Director, Rates & Regulatory Affairs	<p>1. Mr. Broderick testifies that:</p> <ul style="list-style-type: none"> <li>a. Arizona-American's cost of capital is not less than 8.40%.</li> <li>b. It is not appropriate to include short-term debt in the capital structure.</li> <li>c. Arizona-American's proposed rate case expense is \$456,000.</li> </ul> <p>2. Mr. Broderick:</p> <ul style="list-style-type: none"> <li>a. Sponsors the D Schedules.</li> <li>b. Details the Company's proposal to include in rate base \$25 million of Construction Work in Progress associated with the White Tanks Plant and how an O&amp;M deferral mechanism would work.</li> <li>c. Sponsors the Company's request for an Arsenic Cost</li> </ul>	A-11, A-12, A-37	

		<p>Recovery Mechanism for the Tubac Water District.</p> <p>d. Explains the Company's request to recover imputed regulatory advances and contributions.</p> <p>e. Explains the spreadsheet tool that can be used to evaluate the effect of various rate consolidation proposals</p>		
6	Bradley J. Cole: Arizona-American, Director of Operations, Central Arizona	<p>Mr. Cole:</p> <p>1. Provides an overview for each of the six water districts and the one wastewater district.</p> <p>2. Discusses the following topics:</p> <p>a. Need for a mechanism to recover first-year O&amp;M costs for the White Tanks Regional Treatment Facility.</p> <p>b. Need for the Tubac arsenic-treatment facility.</p> <p>c. The Company's proposed storage-tank maintenance program.</p> <p>d. Increases in chemical expenses.</p> <p>e. Proposed changes to service charges.</p> <p>f. White Tanks Plant</p>	A-7, A-8	

		<p>staffing.</p> <p>g. White Tanks Plant O&amp;M savings.</p>		
7	<p>Jeffrey W. Stuck: Arizona-American, Director of Operations, Eastern Arizona</p>	<p>Mr. Stuck discusses the following topics:</p> <ol style="list-style-type: none"> <li>1. Need for Tubac central arsenic-treatment plant.</li> <li>2. Wishing Well Plant upgrade – O&amp;M savings.</li> <li>3. Wishing Well Plant flow growth.</li> </ol>	A-9	
8	<p>Sheryl L. Hubbard: Arizona-American, Manager of Rates and Regulation</p>	<p>Ms. Hubbard:</p> <ol style="list-style-type: none"> <li>1. Sponsors the following schedules: A-2; A-4; A-5; B-6; C-1 through C-3; E-2; E-3; E-6; E-7; E-8; and F-1 through F-4.</li> <li>2. Supports the revenue-requirement calculation for each district.</li> <li>3. Sponsors the lead-lag study that supports Arizona-American's request for cash working capital.</li> <li>4. Sponsors a number of adjustments to operating income.</li> <li>5. Supports inclusion of CWIP in rate base associated with the White Tanks Plant.</li> <li>6. Supports the following requests by Arizona-American: <ol style="list-style-type: none"> <li>a. Power supply</li> </ol> </li> </ol>	A28, A-29, A-30, A-36.	

		<p>adjustment;</p> <p>b. Tank maintenance reserve; and</p> <p>c. For formal adoption by the Commission of the terms and conditions of service on file at the Commission.</p> <p>7. Rebutts various issues raised by Staff and RUCO including cash working capital.</p>		
9	John C ("Jake") Lenderking: Arizona-American, Water Resources Manager.	<p>Mr. Lenderking:</p> <p>1. Discusses Arizona-American's Water Conservation Program and how it will be affected by new ADWR regulations.</p> <p>2. Proposes changes to the current CAP-water surcharge for the Paradise Valley Water District.</p> <p>3. Responds to Mr. Magruder – Arizona-American cannot presently prevent exempt wells in its service area.</p>	A-21-A-22	
10	Ian C. Crooks: Arizona-American, Engineering Manager of Developer Services	Mr. Crooks answers the eleven questions posed by Staff witness Stephen Olea concerning Arizona-American's proposal to amend its Water Facilities Hook-Up Fee for its Agua Fria Water District.	A-6	
11	Linda J. Gutowski: Arizona-American, Senior Rate Analyst	<p>Ms. Gutowski:</p> <p>1. Sponsors rate base Exhibits B-1 through B-5 (including</p>	A-25, A-26, A-27	

		<p>adjustments).</p> <ol style="list-style-type: none"> <li>2. Sponsors a number of income statement adjustments, Schedule E-1, Schedule E-5.</li> <li>3. Sponsors the Present Rate portion of the H Schedules.</li> <li>4. Responds to a number of rate base and income statement issues raised by Staff and RUCO, including: post-test year plant disallowances for insufficient invoice support; accumulated depreciation issues, and inappropriate inclusion of advances and contributions for plant in CWIP.</li> </ol>		
12	<p>Paul R. Herbert: President of the Valuation and Rate Division for Gannett Fleming, Inc.</p>	<p>Mr. Herbert:</p> <ol style="list-style-type: none"> <li>1. Explains the cost-of-service and rate-design studies prepared for each of the operating districts submitted in this case;</li> <li>2. Sponsors Schedules G-1 through G-9, and the proposed-rates portion of the H schedules.</li> <li>3. Responds to the testimony of Staff Witness Mr. Stephen Olea concerning the cost-of-service allocation studies. Mr. Herbert's cost-of-service studies properly reflect the allocation of costs to the various classes of users and can be used as a guide to design the appropriate rates</li> </ol>	<p>A-23, A-24, A-31, A-32, A-39.</p>	

		in this case.		
13	Bente Villadsen: Principal at the Brattle Group.	Dr. Villadsen:  1. Estimates a cost of equity for the benchmark samples at Arizona-American's capital structure to be in the range of 11.0 to 12.5 percent. Arizona-American's request for 11.75 percent is equal to the midpoint.  2. Discusses shortcoming in Staff's and RUCO's return-on-equity recommendations.  3. Explains how recent trends in the financial markets further support her return-on-equity recommendation.	A-13, A-14, A-15	

1 Arizona-American's final rate-base, operating-income, and revenue-requirement  
2 positions are shown in its final schedules, filed on April 10, 2009 (collectively, "AAW's Final  
3 Schedules"). Staff's final positions are shown in its final schedules filed on April 17, 2009  
4 (collectively, "Staff's Final Schedules"). RUCO's final positions are shown in its final  
5 schedules, filed on April 14, 2009, (collectively, "RUCO's Final Schedules"). No other party  
6 filed schedules.

7 During this case the parties were able to work out many of their initial differences, but  
8 there still remain significant differences in rate base and cost of capital, as well as smaller  
9 revenue and expense issues. The appropriate cost of capital is an issue common to all districts.  
10 The remaining issues generally affect one or more districts. For each issue, Arizona-American  
11 will identify the affected district.

1 **III WHITE TANKS PLANT ISSUES (Agua Fria Water)**

2 Two of the biggest issues in this case concern the White Tanks Regional Water  
3 Treatment Plant (“White Tanks Plant”), currently under construction in Arizona-American’s  
4 Agua Fria Water District. These are:

- 5 • Should the Commission approve the inclusion of \$25 million of White Tanks Plant  
6 CWIP in rate base; and
- 7 • Should the Commission approve a deferral mechanism to allow recovery of  
8 incremental O&M expenses incurred once the White Tanks Plant enters service.

9 There are also two other issues that will be discussed in this section: changes to the  
10 existing accounting approvals for the White Tanks Plant; and changes to the existing hook-up fee  
11 mechanism approved in the Agua Fria Water District to finance the White Tanks Plant.

12 **A CWIP IN RATE BASE**

13 Arizona-American proposes to include in rate base \$25 million of Construction Work in  
14 Progress (“CWIP”) associated with the White Tanks Plant. This is roughly 40% of the expected  
15 \$62 million direct construction cost of the facility.<sup>11</sup>

16 The White Tanks Plant, currently under construction, will allow Arizona-American to  
17 treat its 11,093 acre-feet per year allotment of Central Arizona Project (“CAP”) water, for  
18 distribution to customers in the Agua Fria Water District.<sup>12</sup> The White Tanks Plant is designed  
19 to treat 13.5 million gallons per day (“MGD”) in Phase I(a). It is expandable to 20 MGD in  
20 Phase I(b) with the addition of one more treatment-unit train. Eventually the White Tanks Plant  
21 can accommodate the addition of three additional 20-MGD phases, for a total treatment capacity  
22 of 80 MGD at the 46-acre plant site. With expansion, the White Tanks Plant will be able to treat  
23 additional CAP water or other surface-water supplies.

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<sup>11</sup> Exhibit A-2 at 1:16-18.

<sup>12</sup> This paragraph, Exhibit A-1 at 3:6-15.

1           The White Tanks Plant has been under construction for over one year and is on schedule  
2 to be in service by December 2009, at a total project cost of approximately \$62 million.<sup>13</sup>  
3 Through December 2008, over \$30 million has been paid to Garney Construction, the  
4 construction contractor. Maricopa Water District (“MWD”) is constructing the water-supply  
5 intake on the Beardsley Canal, which should be completed by spring 2009. In the late spring of  
6 2009, Arizona-American will begin construction of the \$2.5 million water-transmission main to  
7 connect the White Tanks Plant to Arizona-American's existing transmission system.  
8 Construction of the transmission main should be completed by fall 2009, in time for start-up of  
9 the White Tanks Plant.

10           The White Tanks Plant is badly needed in the West Valley.<sup>14</sup> Over the years, ground  
11 water levels have been declining in the West Valley. As the water table has dropped, Arizona-  
12 American has experienced declining water quality and increasing well rehabilitation and  
13 pumping costs. New wells in this area almost always require expensive arsenic-treatment  
14 facilities to comply with federal water quality standards. Even without adding new customers,  
15 groundwater levels would continue to drop as the current demand on the aquifer outstrips  
16 groundwater replenishment.

17           This project is necessary to insure our current customers in the Agua Fria Water District  
18 have a reliable, sustainable source of potable water, now and into the future.<sup>15</sup> Arizona-  
19 American plans to dispatch the plant as the first resource to meet base-load demand in the service  
20 area but will continue to utilize existing wells to assist in meeting that base load, and for peaking  
21 during summer peak loads. Upon completion, the White Tanks Plant will immediately reduce  
22 the withdrawal of ground water by up to 13.5 million gallons per day (mgd) providing a vehicle  
23 for the Company to incorporate the use of a renewal source of water supply.

24           Other parties have recognized the benefits of the White Tanks Plant. RUCO evaluated  
25 the proposed White Tanks Plant and concluded:

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<sup>13</sup> This paragraph, Exhibit A-2 at 1:16-24.

<sup>14</sup> This paragraph, Exhibit A-2 at 2:3-19.

<sup>15</sup> *Id.*

1 The facts, which are not in dispute, are that the Company needs to serve its  
2 customers and construction of a treatment plant is necessary to meet the Company's  
3 service requirements.<sup>16</sup>

4 Staff recognized that the White Tanks Plant would provide "potential public benefits"  
5 including the ability to use surface water instead of ground water in light of the diminishing  
6 quantity and quality of groundwater.<sup>17</sup>

7 Because of its financial condition, Arizona-American could not obtain internal approval  
8 to finance the White Tanks Plant through conventional means, where a company builds a facility  
9 and then seeks rate recovery in a subsequent rate case. As Mr. Buls stated:

10 [B]ecause of the dire financial condition of Arizona-American, Arizona-American  
11 needed to minimize the negative financial impacts associated with a project of this  
12 size.<sup>18</sup>

13 RUCO accepted that Arizona-American could not finance the White Tanks Plant under the  
14 traditional ratemaking model:

15 There is no dispute that the company is not in the position to finance the construction  
16 at this time and seek recovery of its investment after the facility is completed.<sup>19</sup>

17 Because it could not begin the White Tanks Plant by financing through conventional  
18 means, Arizona-American proposed to finance the project through increased hook-up fees  
19 assessed on new construction.<sup>20</sup> Arizona-American has seen hookup fees work effectively  
20 elsewhere and for other purposes. Given the explosive growth Arizona-American had already  
21 experienced in this area and projections for future growth, Arizona-American viewed the hook-  
22 up fees as an efficient way to finance the plant. The use of hookup fees would potentially reduce  
23 the financial impacts to current customers without further exacerbating the already difficult  
24 financial situation Arizona-American was in.

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<sup>16</sup> Exhibit A-33 at 5:14-16.

<sup>17</sup> Tr. at 807:12 – 808:1.

<sup>18</sup> Exhibit A-20 at 3:16-18.

<sup>19</sup> Exhibit A-33 at 5:11-13.

<sup>20</sup> This paragraph, Exhibit A-20 at 3:19-24.

1 RUCO and Staff both supported Arizona-American's request, which the Commission  
2 approved in Decision No. 69914, dated March 27, 2007.

3 Arizona-American is a public service corporation. As a regulated utility, it has an  
4 obligation to provide water utility service to its customers at reasonable rates. The  
5 Company has demonstrated a need to build the proposed plant and has presented a  
6 sound plan by which to finance its construction.<sup>21</sup>

7 However, since the date of the Commission's Order, a fundamental assumption, which all parties  
8 used to support hook-up fee financing, drastically changed for the worst.

9 Because of the decline in home construction, which has been particularly steep in the  
10 West Valley, hook-up fee forecasts have also declined precipitously. In 2006, the parties were  
11 expecting 3,000-3,500 new customers per year in the Agua Fria Water District.<sup>22</sup> Now, the latest  
12 growth forecast shows the extent of the customer growth drop-off:<sup>23</sup>

<b>Year</b>	2008	2009	2010	2011	2012	2013
<b>Customers</b>	539	455	594	720	986	1014

13  
14  
15 Due to a number of factors, the number of customers that will actually be subject to hook-up fees  
16 is only a small fraction of the 3,000 to 3,500 customers originally forecast.<sup>24</sup>

<b>Year</b>	2008	2009	2010	2011	2012	2013
<b>Customers</b>	48	98	154	293	545	645

17  
18  
19 Based on the initial growth projections, Arizona-American expected that the entire plant would  
20 be funded by the year 2013.<sup>25</sup> Current projections now show that collections will only be about  
21 \$8 million over that same time frame.<sup>26</sup>

22 We do not know of anyone that saw the magnitude of the real-estate slowdown coming,  
23 while certainly everyone understood that the customer-growth-rate assumptions were key to

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<sup>21</sup> Decision No. 69914 at 21:5-7.

<sup>22</sup> Exhibit A-34 at Schedule JJD-2.

<sup>23</sup> Exhibit A-2 at 3:4-5.

<sup>24</sup> Exhibit A-2 at 3:10-13.

<sup>25</sup> Exhibit A-20 at 4:2-4.

<sup>26</sup> Exhibit A-20 at 4:7-8.

1 developing the hook-up fee financing method, and might have to be revisited in a later case. For  
2 example in its White Tanks Staff Report, Staff stated:

3 Each of the company's proposed and Staff recommended hookup fees are the result  
4 of numerous assumptions. There could be many inaccurate assumptions such as  
5 customer growth rates and meter size, new third-party contracts, inflation,  
6 construction cost increases, et cetera. The company has indicated that when it files  
7 its 2008 rate case for Agua Fria using a 2007 test period, it agrees to update its  
8 assumptions and propose adjustments to the hookup fee as appropriate.<sup>27</sup>

9 The situation is even worse than it initially appears. A utility is traditionally allowed to  
10 capitalize interest costs (Allowance for Funds Used during Construction or "AFUDC")  
11 associated with constructing a capital project and then recover the capitalized AFUDC in rates.  
12 The asset, including the capitalized AFUDC expense, is then depreciated like any other asset.  
13 However, financing the White Tanks Plant with hook-up fees added a new wrinkle. Arizona-  
14 American would normally begin incurring depreciation expense on the unfunded plant and  
15 associated AFUDC at the time the facility went in service until hook-up fees fully funded the  
16 plant. This would have significantly reduced earnings over the expected three to four-year time  
17 period. Accordingly, the Commission approved Arizona-American's request to defer  
18 depreciation and continue AFUDC on the unfunded plant balance.<sup>28</sup>

19 The Company can only recognize post-in-service AFUDC to the extent that there are  
20 sufficient hook-up fees. Because hook-up fee receipts have nearly dried up, the harm to  
21 Arizona-American for the foreseeable future would be enormous. Mr. Buls estimated: "Arizona-  
22 American would suffer financial harm of roughly \$5.4 million per year as we would be carrying  
23 a \$60 million dollar asset with no return."<sup>29</sup>

24 To mitigate the recognized financial harm, Arizona-American proposed to include in rate  
25 base \$25 million of CWIP associated with the White Tanks Plant.<sup>30</sup> It is important to note that

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<sup>27</sup> Exhibit A-34 at 4 (emphasis added).

<sup>28</sup> Decision No. 69914 at 28:23 – 29:6.

<sup>29</sup> Exhibit A-20 at 8:9-11.

<sup>30</sup> Exhibit A-11 at 11:3-15.

1 this proposal would only mitigate, not eliminate, the expected financial harm by slowing down  
2 the expected growth in the plant balance account attributable to the AFUDC.<sup>31</sup>

3 The proposal is fair to customers for three reasons. First, allowing Arizona-American's  
4 financial condition to further deteriorate is not in customers' best interests.

5 It is important to note that the continuing financial losses and resulting actions by  
6 management impact not only Arizona-American's shareholder, but also its  
7 customers. Because of diminished returns to the shareholder, there is diminished  
8 investment in Arizona-American, diminished staffing, diminished spending, and as a  
9 result diminished service to Arizona-American's customers.<sup>32</sup>

10 The second reason that allowing CWIP in rate base is fair to customers is that current  
11 customers will benefit from the White Tanks Plant. The plant is expected to enter service in the  
12 fourth quarter of 2009, shortly after new rates should go into effect in this case.<sup>33</sup> As discussed  
13 above, the White Tanks Plant will immediately begin displacing ground water use with CAP  
14 water, a renewal source of supply, with all the attendant benefits to current customers.

15 The third reason that the proposal is fair is that it will mitigate rate shock and enable rate  
16 consolidation in the near future. If the proposal is not approved, Arizona-American would likely  
17 have no alternative but to file another rate case to put the entire White Tanks Plant in rate base.<sup>34</sup>  
18 Mr. Becker testified that Staff would consider supporting the request in the next Agua Fria  
19 district rate case, assuming all the normal conditions were satisfied:

20 As long as you include a used and useful determination in your question, that we've  
21 analyzed it and the engineer has looked at it in terms of used and usefulness and  
22 appropriate capacity or whatever, and, you know, correct depreciation and all of that,  
23 if we have all of the ingredients that Staff customarily uses, I would have to give you  
24 a hypothetical, yes, we would consider it.

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<sup>31</sup> Exhibit A-20 at 6:6-9.

<sup>32</sup> Exhibit A-19 at 2:3-7.

<sup>33</sup> Tr. at 175:25 – 176:1.

<sup>34</sup> Exhibit A-11 at 13:22-24.

1 However, this alternative would result in a significant future rate increase for Agua Fria  
2 customers and throw off the timeline (discussed later in the brief) for considering consolidating  
3 the rates for all of Arizona-American's water districts.

4 Judge Wolfe recognized the potential rate-shock mitigation of allowing CWIP in rate  
5 base.

6 Q. (Judge Wolfe): Could it be, if that were to occur -- and we don't know what  
7 is going to happen -- could it be that it would be easier for ratepayers to  
8 swallow if part of the CWIP were to go into rate base in this case so that they  
9 wouldn't be hit with the total amount of the plant in the next rate case?

10 A. (Mr. Becker): Well, I don't think any rate increase is ever easy for the  
11 ratepayers. It may help to minimize the future rate increase only because of  
12 the mechanics of the arithmetic of doing it now. And also, you know, and  
13 you have to be fair to the company. You know, if they do put CWIP in rate  
14 base, you know, then theoretically the AFUDC is going to stop. Okay.

15 Q. So they would have to weigh the cost-benefit analysis?

16 A. That's right. The company spells that out in -- I believe they spell it out in  
17 some of their testimony about, you know, about how putting some of it in  
18 rate base now is going to, you know, benefit the company and the ratepayers  
19 in the long run. So to answer your question, that's, you know, that's it.<sup>35</sup>

20 Arizona-American does not dispute that allowing CWIP in rate base, while not  
21 unprecedented, does depart from traditional rate-making. Arizona-American likewise accepts  
22 the consequential reduction in AFUDC which would result from placing CWIP in rate base.  
23 However, the circumstances in this case do justify this departure. As Staff testified:

24 The reasonableness of a variance request should be evaluated on a case-by-case  
25 basis. Established ratemaking practices have become accepted for good reason.  
26 Essentially, in normal circumstances, a normally recognized treatment is considered  
27 equitable. However, some instances are unusual and call for a variance. As noted  
28 above, the projected capital required to finance the White Tanks plant is relatively  
29 large in comparison to Arizona-American's existing capital structure.

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<sup>35</sup> Tr. at 856:19 – 857:14.

1 Typically, the advantages and disadvantages of the various leads and lags pertaining  
2 to the ratemaking process tend to provide a balance that is equitable to investors and  
3 ratepayers. However, any imbalance is magnified by large variances from the  
4 normal activity. Accordingly, the White Tanks project has the potential to introduce  
5 a significant imbalance due to its relatively large size.<sup>36</sup>

6 To be accurate, Staff was discussing above Arizona-American's proposal to finance the  
7 White Tanks Plant with hook-up fees. However, Staff's reasons for departing from traditional  
8 rate-making practice are equally applicable to Arizona-American's proposal to include in rate  
9 base \$25 million in CWIP associated with the White Tanks Plant. We are where we are through  
10 no fault on anyone's part. Given the current circumstances, including a portion of CWIP in rate  
11 base is fair to customers and to Arizona-American.

12 **O&M DEFERRAL MECHANISM**

13 Arizona-American proposed an O&M deferral mechanism for White Tanks that was  
14 essentially the same as an ACRM surcharge mechanism.<sup>37</sup> An ACRM mechanism authorizes a  
15 deferral of 12 months of initial actual O&M expenses. At the conclusion of the initial 12-month  
16 period, Arizona-American would submit evidence of actual O&M expense along with the other  
17 required schedules and approximately ninety days later a surcharge rate increase would be  
18 authorized which recovers two times the actual O&M expense (i.e., the deferred expenses plus  
19 an equal amount to recover the on-going expenses). And at the end of 12 months following  
20 implementation of the surcharge, the surcharge would be reduced down to an amount equal to  
21 the actual on-going expenses (which are equal to the actual expenses from the deferral period)  
22 until the completion of the next rate case which places on-going expenses in permanent rates.

23 Arizona-American estimated that first year O&M expenses associated with the White  
24 Tanks Plant would be \$1.927 million.<sup>38</sup> However, because the White Tanks Plant will treat  
25 surface water, its O&M expenses would be somewhat offset by O&M savings resulting from not

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<sup>36</sup> Exhibit A-35 at 15:23 – 16:8.

<sup>37</sup> This paragraph, Exhibit A-11 at 16:18-23.

<sup>38</sup> Exhibit A-7 at Exhibit BJC-1.

1 having to pump and treat as much ground water.<sup>39</sup> Arizona-American estimates that the annual  
2 savings would be \$821,903 in electricity and chemical costs.<sup>40</sup> Therefore, the net increase in  
3 O&M is estimated to be \$1.1 million.

4 Staff and RUCO opposed Arizona-American's request. However, not granting this  
5 request would cause even further financial harm to Arizona-American if it has no opportunity to  
6 recover the O&M costs of a plant providing service to its customers until Arizona-American's  
7 next rate case.<sup>41</sup> Using the following assumptions; (i) the plant goes into service November 1,  
8 2009, (ii) annual operating costs are \$1.1 million per year, and (iii) Arizona-American's next  
9 Agua Fria Water District test year ends December 31, 2009 and the Commission orders rates  
10 effective August 31, 2011, Arizona-American will have operated the plant for 22 months at a  
11 cost of \$91,167 per month, which is equal to a total loss of over \$2.0 million.<sup>42</sup> As Arizona-  
12 American's President, Paul Townsley, testified: "For any company the size of Arizona-American  
13 this is a sizeable impact; for a company which is already hemorrhaging money it is truly  
14 devastating."<sup>43</sup>

15 If some kind of mechanism to defer and recover these costs could not be approved,  
16 Arizona-American would seriously consider mothballing the White Tanks Plant:

17 Q. (Chairman Mayes): And if the Commission were not to grant you that  
18 approach, I think -- I know you have not testified to it, but I am sure you are  
19 aware -- the intention would be to mothball the project?

20 A. (Mr. Townsley): ... I want to be very clear, no decision has been made on  
21 whether to mothball this plant or not. It's premature today to make that  
22 decision. But as a prudent manager I really do need to look at all of my  
23 options, and if I have an avoided \$1.1 million a year of operating costs that I  
24 defer until later when I need to start up the plant, I need to seriously think  
25 about that.<sup>44</sup>

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<sup>39</sup> Exhibit A-8 at 3:7-11.

<sup>40</sup> *Id.* at 5:1-12.

<sup>41</sup> Exhibit A-19 at 5:18-20.

<sup>42</sup> *Id.* at 5:24 - 6:3.

<sup>43</sup> *Id.* at 6:3-4.

<sup>44</sup> Tr. at 411:25 - 412:22.

1           Because of opposition to an ACRM-like mechanism, Mr. Townley clarified that Arizona-  
2 American would be able to accept an authorization to defer the White Tanks O&M costs and  
3 then recover them in a subsequent rate case:

4           What I'm asking the Commission to allow us to do is to capture these costs  
5 on our balance sheet as a regulatory asset so at the time of the next case, our  
6 next Agua Fria Water case, the disposition of those costs could be  
7 appropriately dealt with, whether it's through an ACRM surcharge or whether  
8 it's through other mechanisms.<sup>45</sup>

9           If the Commission were to authorize some sort of deferral mechanism for the White  
10 Tanks O&M expenses, mothballing the White Tanks plant would be less likely:

11          Q.    (Chairman Mayes): Would the company be satisfied with and avoid having  
12 to take any of the dire measures that Mr. Marks outlined in his opening  
13 statement, including mothballing or selling the plant, if the Commission did  
14 not allow CWIP in rate base but did allow a reg asset?

15          A.    (Mr. Townsley): Well, I guess a half a loaf is better than a whole loaf.

16          Q.    That is a standard utility response. Okay. Well, I mean it is certainly from  
17 our standpoint is something?

18          A.    It is something, and I believe that we acted prudently throughout this whole  
19 process. I believe that we did everything we could to minimize the costs.  
20 And I believe that we have a plant here that benefits both current and future  
21 customers. So people who have characterized this as just a growth project  
22 are missing an important part of the story. But if the Commission were to  
23 give me the half a loaf instead of a whole loaf, that is better than what I have  
24 today.<sup>46</sup>

25           RUCO could support an appropriate O&M deferral mechanism for the White Tanks  
26 Plant:

27          Q.    (Mr. Marks): So just to be clear, a deferral mechanism that would start when  
28 the plant was operational, that would provide for at least 12 months of actual

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<sup>45</sup> Tr. at 415:12-17.

<sup>46</sup> Tr. at 424:15 – 425:10.

1 costs before any sort of recovery could be obtained in the context of a rate  
2 case, RUCO would not oppose that?

3 A. (Mr. Rigsby): Again, that's -- that is something that is outside typical  
4 ratemaking treatment, but I think that is something that RUCO probably  
5 could support.<sup>47</sup>

6 Staff still opposes any sort of O&M deferral mechanism for the White Tanks Plant.<sup>48</sup>

7 Arizona-American proposes the following language in the Commission' order approving  
8 a deferral of O&M expense associated with the White Tanks Plant:

- 9 1. Arizona-American is authorized to defer expenses related to the operation of the  
10 White Tanks Plant commencing with the in-service date through and until the date  
11 of issuance of a rate order including such expenses as recoverable operating  
12 expenses (the "First Rate Order"). White Tanks Plant expenses to be deferred  
13 may include, but are not limited to: labor and labor-related benefits associated  
14 with personnel to operate the White Tanks Plant: power costs; chemicals; waste  
15 disposal expenses; operating supplies and any other expenses directly associated  
16 with the operation of the White Tanks Plant. These expenses shall be recorded in  
17 a deferral account limited exclusively to White Tanks Plant costs.
- 18 2. The amount deferred will be offset by operating cost savings realized elsewhere in  
19 the Agua Fria system which result from the reduction in water production from  
20 existing ground water sources displaced by the White Tanks Plant. The primary  
21 example of savings would be lower power and chemical costs due to reductions in  
22 ground water pumping. Arizona-American shall track the savings quarterly and  
23 in sufficient detail to facilitate subsequent review in a future rate proceeding.  
24 Arizona-American shall file annually a report detailing the expenses and savings  
25 such that Staff and RUCO may review said expenses and savings for  
26 reasonableness.

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<sup>47</sup> Tr. at 721:2-9.

<sup>48</sup> Tr. at 818:10-18.

1           3.       During the period prior to the First Rate Order, Arizona-American shall file  
2                   annually an earnings test for the Agua Fria Water district so that in the unlikely  
3                   event Arizona-American earns more than its authorized return on rate base as a  
4                   result of the deferral, it would reduce the amount of the deferral to bring earnings  
5                   down to the authorized return.

6           4.       Arizona-American Water shall be authorized to:

- 7                   a.       Defer the sum of its White Tanks Plant's Operations and Maintenance  
8                   ("O&M") expenses less the realized cost savings resulting from  
9                   production shifts as a regulatory asset in Account 186, Miscellaneous  
10                  Deferred Debits;
- 11                  b.       Accrue interest on the outstanding deferred O&M balance at its prevailing  
12                  short-term rate;
- 13                  c.       Beginning on the date of the First Rate Order, amortize such regulatory  
14                  asset over a reasonable time period to be determined in the First Rate  
15                  Order, but in no case shall this period exceed three times the period from  
16                  the in-service date to the date of said order; and
- 17                  d.       Include such amortization as a recoverable expense.

18           **C       HOOK-UP FEE ACCOUNTING CHANGES**

19           In Decision No. 69914, dated September 27, 2007, the Commission approved Arizona-  
20           American's request to increase its existing WHU-1 tariff to fund construction of its planned  
21           White Tanks Plant. Arizona-American asks for certain refinements to how the tariff is applied,  
22           to ensure that incremental funds collected as a result of the hook-up fee increase are applied  
23           toward the White Tanks Plant.

24           During the period from the date of the Commission's final order in this case until the  
25           White Tanks Plant enters service, all proceeds generated from the increase in the WHU-1 tariff  
26           should be applied to the White Tanks Plant.<sup>49</sup> This ensures that additional funds generated by the

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<sup>49</sup> This paragraph, Exhibit A-11 at 20:10-13.

1 Commission-approved increase in the WHU- 1 are applied as intended -to finance the White  
2 Tanks Plant.

3           Once the White Tanks Plant enters service, Arizona-American proposes the following  
4 accounting for the hook-up fees:<sup>50</sup>

- 5           1. Each month Arizona-American will amortize incremental (amount above the original  
6 hook-up fee) WHU-1 fees in an accelerated amount, but not to exceed the total post  
7 in-service AFUDC accrued in that month. This will result in the recovery of an  
8 amount equivalent to post-in-service AFUDC each month and keep the deferred  
9 accumulated balance of post-in-service AFUDC at zero.
- 10          2. Next, each month Arizona- American will also amortize in an accelerated amount  
11 remaining available incremental WHU- I fees in an amount not to exceed the monthly  
12 depreciation expense for the White Tanks Plant.
- 13          3. Next, each month the remaining incremental WHU-1 funds, if any, will be applied as  
14 a contribution to the White Tanks Plant. All such contributions shall reduce the  
15 White Tanks Plant balance in the next month for purposes of calculating post-in-  
16 service AFUDC, depreciation expense, and the White Tanks Plant balance.
- 17          4. However, if the accumulated incremental WHU-1 funds in any month are insufficient  
18 to cover the post-in-service AFUDC or to allow its amortization to fully offset White  
19 Tanks Plant's depreciation expense, Arizona-American will defer the unrecovered  
20 post-in-service AFUDC and depreciation expense for recovery at a time when hookup  
21 fees are sufficient or until it is included in rate base. This will be accomplished by  
22 using the accumulated amounts in account 271161 as a balancing account.

23           This fourth request is especially important in light of the reduced growth forecasts. The  
24 accounting changes are important so that Arizona-America's earnings are not hurt by relying on  
25 hook-up fee collections.<sup>51</sup> By recovering post-in-service AFUDC as it is incurred, Arizona-

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<sup>50</sup> This paragraph, Exhibit A-11 at 22:10 – 23:6.

<sup>51</sup> This paragraph, Exhibit A-11 at 23:14-21.

1 American will recover its White Tanks Plant cost of capital on an on-going basis. If hook up fee  
2 collections are insufficient to cover post-in-service AFUDC as it is incurred, the Company would  
3 incur a reduction in reported earnings, because it could not defer the equity portion of post-in-  
4 service AFUDC. Instead, earnings would be reduced. So, earnings would be reduced if the  
5 Commission does not approve the requested accounting modifications. Arizona-American does  
6 not believe that the Commission intended to reduce the Company's earnings when it approved  
7 the hook-up fee increases.

8 The proposed accounting changes also benefit customers.<sup>52</sup> Arizona-American's  
9 proposal clearly identifies the amount of hook-up fees available to the White Tanks Plant and  
10 minimizes the post-in-service AFUDC and deferred depreciation expense which are ultimately  
11 paid for by customers.

12 Staff does not oppose Arizona-American's request. RUCO opposes Arizona-American's  
13 request.<sup>53</sup>

14 **D HOOK-UP FEE LANGUAGE CHANGES**

15 As a result of the planned White Tanks Plant completion, Arizona-American has reduced  
16 the need for developers to bring new wells.<sup>54</sup> But while this benefits developers, Arizona-  
17 American does not benefit while it is constructing the White Tanks Plant as it is not receiving  
18 adequate cash until the developer works off the credits against any of the developer-built  
19 common facilities. The solution is to separate the single fee hook-up fee into two components  
20 with the second component (the White Tanks portion) ineligible for offset credits. The original  
21 hook-up fee (\$1,150 - Component A) will continue to be used to pay for Arizona-American's  
22 existing investment in common facilities and will be eligible for offset against developer built  
23 common facilities. The White Tanks portion of the hookup fee (Component B) will not be  
24 eligible for offset against developer built common facilities and will always be applied towards  
25 White Tanks plant.

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<sup>52</sup> This paragraph, Exhibit A-11 at 24:9-11.

<sup>53</sup> Exhibit R-12 at 17:1-10.

<sup>54</sup> This paragraph, Exhibit A-12 at 4, 12-22.

1 The proposed amended tariff is attached to Exhibit A-12 as Exhibit TMB-R2.

2 RUCO did not oppose the requested amendment. Staff did ask Arizona-American to  
3 answer certain questions concerning the request.<sup>55</sup> Mr. Crooks provided those answers on behalf  
4 of Arizona-American.<sup>56</sup> At hearing, Staff stated that it agreed with the Company's proposal  
5 except in the specific instance when the developer was also providing a well.<sup>57</sup>

6 **IV RATE BASE ISSUES**

7 The parties' final rate-base positions follow:

	Agua Fria Water	Havasu Water	Mohave Water	Paradise Valley Water	Sun City West Water	Tubac Water	Mohave Wastewater
Arizona-American	92,049,310	3,869,261	10,235,260	37,398,279	38,382,791	1,457,349	5,137,269
Staff	59,508,624	3,899,808	8,903,146	37,076,955	37,235,836	1,420,999	647,473
RUCO	64,339,234	3,175,549	10,652,507	36,953,320	38,260,185	1,423,691	2,632,661

8 **A CWIP IN RATE BASE (Agua Fria Water)**

9 This issue is discussed in Section III (A), above.

10 **B WISHING WELL TREATMENT PLANT REHABILITATION (Mohave**  
11 **Wastewater)**

12 The Wishing Well Wastewater Treatment Plant was built many years ago by Sorenson  
13 Utilities. Sorenson Utilities was acquired by Citizens Utilities in March 1999.<sup>58</sup> Then, in 2001  
14 Arizona-American acquired Citizens Utilities' Arizona water and wastewater assets. By 2005, it  
15 became obvious to Arizona-American that the Wishing Well Plant needed to be upgraded for  
16 two reasons. First, several of the plant's components needed to be replaced. Although the  
17 Wishing Well Plant was permitted by ADEQ at 0.500 mgd, the design capacity was only 0.250  
18 mgd, and the operational capacity was approximately 0.200 mgd, due to degraded plant  
19 components. To restore the design capacity, many plant components needed to be replaced.

<sup>55</sup> Exhibit S-2 at 3:1 at 4:7.

<sup>56</sup> Exhibit A-6.

<sup>57</sup> Tr. at 743:22 – 744:6.

<sup>58</sup> This paragraph, Exhibit A-2 at 11:11-21.

1 Second, the plant needed to be expanded to the permitted capacity of 0.500 mgd to serve  
2 customer growth, which was projected at that time to be substantial.

3 Staff witness Gerald Becker proposes to disallow \$3,932,080 associated with the  
4 rehabilitation and expansion of the Wishing Well treatment plant.<sup>59</sup> This is not based on a claim  
5 of imprudence or that the plant was not in service. Rather, although it traditionally has allowed  
6 verified post-test year plant in service, Staff decided to depart from its past practice, based on an  
7 argument that excluding the plant would not jeopardize the Company's financial health and that  
8 this would be a significant increase to plant. Staff further claimed that the plant construction did  
9 not improve reliability.

10 Staff has historically recommended allowance of post-test year plant if the plant costs  
11 were verified, construction was prudent, and the plant is used and useful. The Commission has  
12 consistently allowed this post-test-year plant in service. To Arizona-American's knowledge,  
13 Staff has never departed from its practice, which is certainly fair in light of the regulatory lag  
14 utilities face in Arizona. The Wishing Well Plant rehabilitation/expansion entered service in the  
15 summer of 2008.<sup>60</sup> By the time rates go into effect in this case, the new construction will have  
16 been providing service for at least a year.

17 Arizona-American and other utilities have relied on this precedent to continue making  
18 needed investments after a test year is completed. If Staff's position were approved, the rules  
19 will be re-written, regulatory lag will become even longer, and financial harm will grow even  
20 larger..

21 Although Mr. Becker stated that the plant construction did not improve reliability, Ms.  
22 Hains contradicts him: "The 250,000 GPD plant was incapable of properly treating wastewater  
23 flow, and therefore, the Company expanded the treatment capacity to 500,000 GPD."<sup>61</sup> The new  
24 construction obviously did improve reliability. The Wishing Well Plant is now capable of  
25 properly treating wastewater flows. Further, Ms. Hains testified that without further

<sup>59</sup> This paragraph, Exhibit S-7 at 24:6 – 26:4.

<sup>60</sup> Exhibit S-3; Exhibit DMH-7 at 7.

<sup>61</sup> *Id.* (Emphasis added).

1 construction, the Wishing Well Plant could not continue to meet the standards of its aquifer  
2 protection permit.<sup>62</sup>

3 Excluding the plant from rate base does further jeopardize Arizona-American's health.  
4 Total rate base per Mr. Becker for Mohave Wastewater is just \$647,643, so excluding several  
5 multiples of rate base would likely bankrupt a stand-alone utility. Further, the record is replete  
6 with testimony about how dire Arizona-American's financial health already is. Arbitrarily  
7 excluding \$4 million in prudent construction can hardly help the Company's health and will  
8 certainly hurt it further. At some point, the cumulative effects of these disallowances can only be  
9 fatal.

10 RUCO would disallow one-half the cost of the Wishing Well Plant construction costs  
11 based on its claim that there was excess capacity.<sup>63</sup> This was based on a data response from Ms.  
12 Hains, dated November 7, 2008.<sup>64</sup> However, in her subsequent direct and surrebuttal testimony,  
13 Ms. Hains did not specify any excess capacity at the plant.

14 The capacity issue was not cleared up at the hearing. Ms. Hains testified that there was  
15 unused capacity but that the Company's expansion of the plant was consistent with ADEQ's  
16 guidelines.<sup>65</sup> However, Ms. Hains had no opinion as to what portion of the new construction  
17 costs was attributable to any unused capacity.

18 Q. (Mr. Pozefsky): And what percentage of the plant, in your opinion, is excess  
19 capacity?

20 A. (Ms. Hains): This will be difficult to give you answer, because company  
21 saying they designing the expansion is based on the ADEQ Engineering  
22 Bulletin 11. In there, guidelines saying any plant owner, when they  
23 designing, they should be based on projected 10 to 15 years growth in there.  
24 And then so to making cost effective, they should follow that rule. So I'm not  
25 quite understanding what you aim to.

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<sup>62</sup> Tr. at 762:25 – 763:13.

<sup>63</sup> Exhibit R-9 at 16:1-13.

<sup>64</sup> Exhibit R-9 at 16:18-22; Tr. at 699:19-21.

<sup>65</sup> Tr. at 756:5-21.

1 ADEQ Engineering Bulletin 11 provides guidance as to when a company should add wastewater  
2 treatment capacity.

3 Q. (Mr. Marks): In response to Mr. Pozefsky, you discussed some sort of an  
4 engineering guidance about the term that a company must plan for in a  
5 wastewater treatment facility. What document, what agency was that?

6 A. (Ms. Hains): That Bulletin 11, Engineering Bulletin 11 originated by Arizona  
7 Health Department. When health department separately turned to be health  
8 department and environmental quality department, and DEQ adopted that  
9 engineering bulletin for their review and project use.

10 Mr. Gross included ADEQ Engineering Bulletin 11 with his testimony<sup>66</sup> As specified in  
11 ADEQ Engineering Bulletin 11, for a high growth area like Mohave County Arizona-American  
12 must plan its capacity expansions to meet the needs of its customers over the next 10 to 15  
13 years.<sup>67</sup>

14 Mr. Gross testified that approximately two-thirds of the \$4.3 million of new construction  
15 costs was associated with rehabilitating the plant, not to expand capacity:

- 16 1. New clarifiers were designed to treat up to 0.500 mgd, and the existing undersized  
17 clarifier was converted to provide additional sludge holding volume.
- 18 2. The blowers were upgraded. Existing blowers were aged and provided no  
19 redundancy.
- 20 3. The aeration system was upgraded. The existing system was aged and had many leaks  
21 in the air piping.
- 22 4. A screwpress was added to reduce the high operational costs of hauling liquid sludge.  
23 Operational savings in sludge hauling was projected to pay for the cost of the new  
24 screwpress within three years.
- 25 5. New headworks were constructed, which included a microstrainer and grit chamber.  
26 This replaces the extremely inefficient bar screen basket at the head of the existing

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<sup>66</sup> Ex. A-2, at 17.

<sup>67</sup> Id. at 17:5-6.

1 aeration basin. This new headworks significantly reduces grit and debris  
2 accumulation in the aeration basins, which had decreased plant capacity to under  
3 0.200 mgd.<sup>68</sup>

4 The total cost of the plant rehabilitation was \$2.9 million of the \$4.3 million in new  
5 construction.<sup>69</sup> No party disagreed with these figures and Ms. Hains acknowledged she had the  
6 opportunity to review them.

7 No disallowance is appropriate for so-called excess capacity. Existing flows already  
8 exceeded capacity.<sup>70</sup> The expansion was based on bona fide developer requests for service.<sup>71</sup>  
9 The Commission requires that a utility use a five-year planning horizon for evaluating the need  
10 for new capacity.<sup>72</sup> Based on the developer requests and the Commission's five-year planning  
11 horizon, the expansion was prudent.<sup>73</sup> Finally, the expansion could not reasonably have been  
12 any smaller.<sup>74</sup>

13 If the Commission does determine that some disallowance for excess capacity would be  
14 appropriate, then it should be based only on the amount of construction costs associated with the  
15 capacity expansion, or \$1.4 million.<sup>75</sup> As discussed above, the balance of the costs were incurred  
16 to rehabilitate the plant, which no party disputes was sorely needed.

17 **C PLANT LACKING FINAL INVOICES (Agua Fria and Mohave Water,**  
18 **Mohave Wastewater)**

19 Staff recommended that certain plant be excluded from rate base because final invoices  
20 are not available.<sup>76</sup> RUCO did not support these exclusions.

21 Ms. Gutowski explained why Staff's disallowances would be inappropriate.<sup>77</sup> The  
22 projects are in service, and Staff made no determination the projects are not used and useful.

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<sup>68</sup> Exhibit A-2 at 12:6-19.

<sup>69</sup> *Id.*, table at 13.

<sup>70</sup> *Id.* at 14:14-15

<sup>71</sup> Exhibit A-2 at 14:6 – 15:23.

<sup>72</sup> *Id.* at 17:7-14.

<sup>73</sup> *Id.* at 17:15 – 18:12.

<sup>74</sup> *Id.* at 15:24-30.

<sup>75</sup> *Id.*, table at 13.

<sup>76</sup> Exhibit S-7 at 11:4-6.

<sup>77</sup> This paragraph, Exhibit A-26 at 1:23 – 2:5; 4:6-11; 7:23 – 8:7.

1 The costs are based on certified engineering estimates. It would be punitive not to include  
2 million-dollar projects in rate base, just because of difficulties getting paperwork from the  
3 developer, or because the developer is bankrupt.

4 **D INCLUSION OF AIAC AND CIAC FOR PLANT IN CWIP (All Districts)**

5 Staff and RUCO make a number of adjustments to include in rate base advances in aid of  
6 construction (“AIAC”) and contributions in aid of construction (“CIAC”) associated with plant  
7 that is still in CWIP and not in rate base. This is inappropriate.

8 When plant is completed, it is included in rate base. In many cases, all or a portion of the  
9 cost of that plant was funded by developers, either through AIAC or CIAC. Therefore, rate base  
10 should be reduced by the amount of the associated AIAC or CIAC.

11 Staff and RUCO would go further and reduce rate base by including AIAC and CIAC in  
12 rate base for projects that are not yet completed, carried as CWIP, and therefore not part of rate  
13 base.<sup>78</sup> Both Staff and RUCO are under the mistaken impression that Arizona-American  
14 receives funds for AIAC and CIAC. Arizona-American does not receive cash – it receives plant,  
15 such as wells, pumps, tanks, and mains. The developer builds the plant using his funds, and  
16 advances it or contributes it. It is recorded in CWIP and the offset is to either Advances or  
17 Contributions. When the project is completed, it is transferred from CWIP to Utility Plant in  
18 Service. But until it does, the engineering estimate is used to create the entry in CWIP and the  
19 offset entry. There are no “funds” available to build other components or other plant in service  
20 as Staff and RUCO believe. Contrary to their allegations, Arizona-American does not accrue  
21 AFUDC on developer advanced or contributed projects. Later, when the plant is in Utility Plant  
22 in Service, it becomes appropriate to deduct the associated AIAC and CIAC when calculating  
23 rate base. However, when the plant is still in CWIP, it is improper to deduct the associated  
24 AIAC and CIAC because the associated plant is not in rate base.

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<sup>78</sup> This paragraph, Exhibit A-27 at 7:5-17.

1 The plant in question has typically been provided operational acceptance, at which time  
2 the plant enters service and is booked as CWIP.<sup>79</sup> Any associated AIAC and CIAC amounts are  
3 created at the same time, because the time period for developer refunds starts at operational  
4 acceptance. However, the plant is not put in Utility Plant in Service (“UPIS”) until the  
5 Developer provides final invoices and satisfies other requirements, at which time the project  
6 receives final acceptance. Therefore, if a project was not transferred from CWIP to UPIS by the  
7 end of the test year, the associated AIAC or CIAC will show up in rate base, without any  
8 associated plant. This is obviously inappropriate.

9 There are two proper regulatory treatments. One would be to include both the plant and  
10 the associated AIAC and CIAC in rate base. The other would be to exclude both the plant and  
11 the associated AIAC and CIAC from rate base. It is just as inappropriate to include only the  
12 AIAC or CIAC and exclude the CWIP as it would be to include only the plant and exclude the  
13 AIAC or CIAC.

14 Finally, Arizona-American’s position on this issue is consistent with what the  
15 Commission has approved for Arizona Water Company.<sup>80</sup> In Decision No. 68302, dated  
16 November 14, 2004, the Commission approved what the Staff accepted - a reduction in AIAC  
17 for outside-funded projects that remained in CWIP at the end of the test year that were excluded  
18 from rate base. In that case, Arizona Water’s Coolidge and Casa Grande water districts had  
19 outside-funded projects in CWIP. Both districts’ rate base included adjustments to reduce  
20 AIACs for the CWIP excluded from rate base.

21 **E ARSENIC TREATMENT VESSEL SIZING (Agua Fria Water, Havasu**  
22 **Water, and Sun City West Water)**

23 To meet the new federal arsenic standard, Arizona-American was required to construct  
24 and install arsenic-treatment facilities in its Agua Fria Water, Havasu Water, Paradise Valley,  
25 and Sun City West Water Districts.<sup>81</sup>

<sup>79</sup> This paragraph, Exhibit A-36.

<sup>80</sup> This paragraph, Exhibit A-27 at 8:4-12.

<sup>81</sup> Decision No. 68310, dated November 14, 2005; Decision No. 68858, dated July 28, 2006, at 33:5 – 35:9.

1 Staff's claims concerning the size of the installed treatment vessels have no merit. First,  
2 for an iron-oxide based treatment system, the literature recommends for a system operating in  
3 parallel configuration that the empty bed contact time be no less than five minutes and the  
4 maximum flow rate not be greater than five gallons per minute/square foot of media.<sup>82</sup> For a  
5 system in series mode, the maximum flow rates improve to eight gallons per minute and the  
6 minimum contact time decreases to 2.5 minutes. The three plants were designed to satisfy these  
7 standards.<sup>83</sup>

8 Second, operating the vessels in a series mode (the water exiting one vessel) enters the  
9 second vessel) improves treatment effectiveness and allows the second vessel to be rotated into  
10 first place when media is changed at the first vessel.<sup>84</sup> The net result of this flow configuration is  
11 an increase in the media's adsorption capacity of 15-50%, which translates into a proportional  
12 reduction in operating costs.<sup>85</sup>

13 The Agua Fria arsenic-treatment facility includes four 11-foot diameter treatment vessels,  
14 operated in a lead/lag configuration (two vessels operating in series, with a second train of two  
15 vessels operating in series).<sup>86</sup> As discussed in Exhibit A-3, this results in more efficient usage of  
16 the adsorptive-iron media, and therefore a lower lifecycle cost and smaller rate impact.  
17 However, in either mode, the system must be capable of operating with one vessel out of service  
18 for an extended time because periodic replacement of the adsorptive iron media is required. This  
19 media change-out process takes several days to complete. With the vessels operating in single-  
20 stage mode with one unit out of service, the system has a reliable treatment capacity of 1,425  
21 gpm. With the system operating in the lead/lag mode, the system has a nominal rated capacity of  
22 1,235 gpm, assuming that the train with the vessel out of service would operate at 5 gpm/sf and  
23 the other train would operate at 8 gpm/sf.

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<sup>82</sup> Exhibits A-4 and A-5.

<sup>83</sup> Exhibit A-5.

<sup>84</sup> Exhibit A-3.

<sup>85</sup> *Id.*

<sup>86</sup> This paragraph, Exhibit A-2 at 4 5:16.

1 Staff suggests that the plant could effectively operate with just three vessels and therefore  
2 recommends disallowing the \$126,352 cost of one vessel.<sup>87</sup> This would be inappropriate for two  
3 reasons. Because one of the vessels could not be operated in series mode, media costs would  
4 increase per Exhibit A-3. Staff simply ignores treatment-media savings.

5 Second, if only three vessels were provided as Staff suggests, treatment capacity would  
6 be limited to a maximum of 950 gpm with one vessel out of service for required repair or media  
7 replacement.<sup>88</sup> Because of the high concentration of arsenic in the raw water from the two wells  
8 feeding the treatment facility, 950 gpm would be insufficient to treat the 1400 gpm capacity of  
9 Wells 5.1 and 5.2.

10 The Agua Fria arsenic-treatment was appropriately sized, so it would be inappropriate to  
11 disallow any of the vessel costs.

12 Turning to the Havasu Water arsenic treatment facility, the plant includes two 14-foot  
13 treatment vessels, operated in lead/lag mode, which results in more efficient usage of the  
14 adsorptive-iron media, and therefore a lower lifecycle cost and smaller rate impact.<sup>89</sup> However,  
15 in either mode, the system must be capable of operating with one vessel out of service for an  
16 extended time because periodic replacement of the adsorptive iron media is required.

17 With one unit out of service, i.e., single-vessel operation, the existing system has a  
18 reliable rated treatment capacity of 770 gpm.<sup>90</sup> Although this slightly exceeds the rated capacity  
19 of the existing wells, no smaller standard pressure vessel size (12 feet or smaller) is available to  
20 meet the combined capacity of Wells 8 and 9 with one of the two vessels out of service.  
21 Therefore, the installed system provides the most cost-effective size and configuration available  
22 to reliably meet the arsenic treatment needs for this facility.

23 Staff's recommended vessel configuration has been a moving target. Ms. Hains  
24 originally proposed that Arizona-American should have installed either one 14-foot vessel or two

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<sup>87</sup> Exhibit S-4 at 3:11-25.

<sup>88</sup> This paragraph, Exhibit A-2 at 4:21-25

<sup>89</sup> This paragraph, Exhibit A-2 at 5:17 – 6:15.

<sup>90</sup> This paragraph, Exhibit A-2 at 6:24 – 7:5.

1 nine-foot vessels.<sup>91</sup> Then in rebuttal testimony, Ms. Hains increased the required size of the  
2 vessels, maintaining that two ten-foot vessels would be adequate.<sup>92</sup> Finally, at the hearing Ms.  
3 Hains testified that Arizona-American should have instead install two 11-foot diameter vessels  
4 and recommends a \$34,266 disallowance, based on the difference between \$252,704 for two 11-  
5 feet diameter tanks, and \$286,960 for two 14-foot diameter tanks.<sup>93</sup>

6 Arizona-American has not analyzed Ms. Hains' final recommendation, but stands by its  
7 choice of two 14-foot vessels. Mr. Gross' uncontroverted testimony is that: "no smaller standard  
8 pressure vessel size (12 feet or smaller) is available to meet the combined capacity of Wells 8  
9 and 9 with one of the two vessels out of service."<sup>94</sup>

10 Finally, the Sun City West arsenic treatment facility includes four 12-foot diameter  
11 vessels, operated in lead/lag mode.<sup>95</sup> Again, this mode reduces media costs and provides for  
12 more reliable treatment capacity. With the vessels operating in single-stage mode with one unit  
13 out of service, the system has a reliable treatment capacity of approximately 1,700 gpm. With the  
14 system operating in the lead/lag mode, capacity would be reduced to 1,470 gpm, because the  
15 train with the vessel out of service would operate at 5 gpm/sf, and the complete lead/lag train  
16 would operate at 8 gpm/sf.

17 The Sun City West arsenic-removal plant requires some special operations. Because the  
18 combined capacity of the two wells exceeds both of these ratings, a percentage of the raw water  
19 must be bypassed and blended with effluent from the arsenic-treatment plant in order to allow  
20 the wells to operate at their maximum rated capacities and not exceed the manufacturer's loading  
21 rate recommendations. With by-passing about 20 percent of the raw water flow, the system can  
22 still achieve the target finished water arsenic concentration of 8 ppb with one vessel out of  
23 service for media replacement.<sup>96</sup>

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<sup>91</sup> Exhibit S-3; Exhibit DMH-3 at 9-10.

<sup>92</sup> Exhibit S-4 at 4:13-17.

<sup>93</sup> Tr. at 746:21-25.

<sup>94</sup> Exhibit A-2 at 7:1-3.

<sup>95</sup> This paragraph, Exhibit A-2 at 7:19 – 8:19.

<sup>96</sup> This paragraph, Exhibit A-2 at 8:19-25.

1 Ms. Hains first recommended that Arizona-American should have installed just three 12-  
2 foot vessels.<sup>97</sup> Then, in her rebuttal testimony, she increased her recommendation to four 11-foot  
3 vessels, with an associated disallowance of \$92,080.<sup>98</sup>

4 Again Arizona-American stands by its actual construction. Even with four 12-foot  
5 vessels, blending is required to adequately remove arsenic. Staff has not shown that blending  
6 could satisfactorily remove arsenic to the targeted 8 ppb, with one vessel out of service.

7 **F ACCUMULATED DEPRECIATION (All Districts)**

8 This is a RUCO issue. RUCO would recalculate accumulated depreciation, based on its  
9 belief that Arizona-American must adhere to a mid-month depreciation convention.<sup>99</sup>

10 Arizona-American calculates depreciation using the end-month plant balances.<sup>100</sup> GAAP  
11 allows a company to use one of three times in a month to calculate depreciation: the beginning;  
12 the end; or the middle. Arizona-American's end-of-month depreciation methodology is accepted  
13 by outside auditors and the Staff, and complies with all Sarbanes-Oxley requirements.

14 Over the life of an asset, all three conventions yield the same total depreciation  
15 expense.<sup>101</sup> Arizona-American's case is based on the actual depreciation expenses booked and  
16 approved by the auditors. RUCO would improperly substitute fictional depreciation expenses  
17 and accumulated depreciation balances.

18 **G CASH WORKING CAPITAL (All Districts)**

19 Arizona-American and Staff are largely in agreement as to the correct calculations of  
20 cash working capital.<sup>102</sup> For each district, the balance is positive. By contrast, RUCO's final  
21 cash working capital balances are negative for five of the districts, and substantially lower for  
22 two of the districts.<sup>103</sup>

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<sup>97</sup> Exhibit S-3; Exhibit DMH-5 at 7.

<sup>98</sup> Exhibit S-4 at 5:5-21.

<sup>99</sup> Exhibit R-9 at 10:11-20.

<sup>100</sup> This paragraph, Exhibit A-26 at 9:7-12.

<sup>101</sup> Exhibit A-26 at 9:13.

<sup>102</sup> Issues matrix, AAW's Final Schedules, Staff's Final Schedules.

<sup>103</sup> Issues matrix, RUCO's Final Schedules.

1 The major issue concerns RUCO's use of 254 days to calculate the average daily revenue  
2 in its revenue lag calculation.<sup>104</sup> Water consumption by the Company's customers occurs on a  
3 daily basis and the associated average daily revenue should be calculated using a full year or 365  
4 days.<sup>105</sup> The corresponding account receivable balance should also be calculated based on 365  
5 days, which has been Arizona-American's practice.<sup>106</sup> By using the accounts receivable balance  
6 on Friday for the following Saturday and Sunday balances (and Monday bank holidays where  
7 applicable), a 365 day average can be computed, which is the public utility industry standard.<sup>107</sup>

8 **H AMORTIZATION OF IMPUTED REGULATORY ADVANCES (All**  
9 **Districts except Paradise Valley Water)**

10 Commission Decision No. 63584 approved a settlement agreement requiring the  
11 imputation of advances in aid of construction ("AIAC") and contributions in aid of construction  
12 ("CIAC") for ratemaking purposes in future rate proceedings in the former Citizens' Districts.  
13 The amortization period for imputed AIAC ended on July 14, 2008.<sup>108</sup> Arizona-American  
14 proposed, and RUCO agreed, that it was appropriate to include in rate base that final  
15 amortization from January 1 until July 14, 2008.<sup>109</sup>

16 Staff believes that including these amortizations violates the test-year matching  
17 principal.<sup>110</sup> Staff initially believed that Arizona-American was asking to include amortizations  
18 through July 14, 2009, which was incorrect.<sup>111</sup>

19 Staff's misgiving is misplaced.<sup>112</sup> The investment expenses that gave rise to the imputed  
20 regulatory advances were made in the 1990's. Arizona-American shareholders have been  
21 shouldering these expenses in the interim following American Water's acquisition of the affected

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<sup>104</sup> Exhibit A-30 at 2:18-22.

<sup>105</sup> *Id.* at 2:22-24.

<sup>106</sup> *Id.* at 2:24 – 3:1.

<sup>107</sup> *Id.* at 3:1-4.

<sup>108</sup> Exhibit A-12 at 9:18-20.

<sup>109</sup> *Id.*

<sup>110</sup> Exhibit S-7 at 14:22-24.

<sup>111</sup> *Id.* at 14:18-19

<sup>112</sup> Exhibit A-12 at 10:2-9.

1 districts from Citizens in 2002. Further, the amount is known and measurable, in fact the  
 2 amortization amounts and schedule are known precisely and have been for many years.

3 For many reasons not in the Company's control, recovery of these amortization amounts  
 4 has been delayed well past the times contemplated in Decision No. 63584.<sup>113</sup> As a result, the  
 5 2006 test-year shortfall was over \$40 million.<sup>114</sup>

6 Rates will not be set in this case before July 2009, at the earliest—one year after the end  
 7 of the 6.5-year amortization period. As part of its sufficiency review, Staff has recently been  
 8 requiring one year of experience at new rates. This potentially means that the earliest test year  
 9 for a subsequent rate case would end September 2010, which could not be filed until January  
 10 2011 at the earliest. Allowing for 15 months to process the case, Arizona-American could not  
 11 begin to recover the 2008 amortization until April 2012. Based on these assumptions, Staff  
 12 would effectively delay recovery of the known and measurable post-test year amortization for a  
 13 period of almost four years. This is obviously unfair to the shareholders, who have been  
 14 shouldering the costs of these investments since 2002.

15 **V OPERATING INCOME ISSUES**

16 The parties' test-year operating income positions follow:

	Agua Fria Water	Havasu Water	Mohave Water	Paradise Valley Water	Sun City West Water	Tubac Water	Mohave Wastewater
Arizona-American	3,016,852	69,904	298,400	2,039,180	736,286	(40,106)	80,377
Staff	2,866,438	31,111	581,790	1,922,083	664,117	(47,643)	121,936
RUCO	2,559,390	60,552	495,333	2,027,002	616,040	(64,125)	121,659

17 **A ANNUALIZATION OF ACRM STEP 2 INCREASES (Havasu, Paradise**  
 18 **Valley, and Sun City West Water)**

19 The Company's adjusted test year revenues include annualized revenues from the ACRM  
 20 Step 2 increases for Havasu Water, Paradise Valley Water and Sun City West Water districts

<sup>113</sup> *Id.* at 10:23 – 12:4.

<sup>114</sup> *Id.* at 12:10-12.

1 approved in the latter part of 2008. RUCO has accepted the Company's adjusted test year  
2 revenues but Staff's adjusted test year revenues do not include the ACRM Step 2 increases.<sup>115</sup>  
3 Failure to include the ACRM Step 2 increases results in an overstatement of the necessary  
4 revenue increase and incorrect rate design.

5 **B TANK MAINTENANCE EXPENSE (All Water Districts)**

6 The Company proposed, and RUCO accepted, a reserve for tank maintenance expense.  
7 A reserve for tank maintenance is funded by an annual allowance for tank maintenance costs in  
8 the expenses of a utility. The funds collected through rates are recorded on the balance sheet in a  
9 deferred liability account – Reserve for Tank Maintenance. As the Company incurs tank  
10 maintenance expenses, the Reserve for Tank Maintenance account is charged reducing the  
11 balance of funds reserved. In subsequent rate cases, actual tank maintenance expenditures and  
12 the reserve account may be reviewed and the annual allowance can be increased, decreased or  
13 remain unchanged on a going forward basis as the circumstances warrant. Use of a maintenance  
14 reserve protects Arizona-American's customers, as RUCO's witness Rigsby acknowledges,  
15 because all revenue collected is offset by actual expenditures made by Arizona-American to  
16 maintain its tanks resulting in no over-collection of tank maintenance expense.<sup>116</sup>

17 Arizona-American used a nine-year period, 2009 to 2017, to estimate its tank  
18 maintenance expenses that formed the basis of its request for an annual allowance.<sup>117</sup> The tank  
19 maintenance expenses were estimated based on size and whether the maintenance was for  
20 interior or exterior coatings.

21 Staff computed a three-year average of maintenance expense in response to Arizona-  
22 American's request for a reserve for tank maintenance. This methodology is deficient in  
23 quantifying maintenance expense especially in districts where the Company admitted, no tank  
24 maintenance activities have been performed in the three year period.<sup>118</sup>

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<sup>115</sup> Issues Matrix.

<sup>116</sup> Exhibit A-29 at 14:16-19

<sup>117</sup> This paragraph, Exhibit A-10 at 2 – 5.

<sup>118</sup> Exhibit A-29 at 14:20-23.

1           **C       DEPRECIATION EXPENSE (All Water Districts)**

2           Staff did not accept Arizona-American's proposed uniform 15-year depreciation rate  
3 (6.67% per year) for meters. Instead Staff continues to use various rates for the various districts  
4 (Agua Fria 2.51%, Havasu 3.52%, Mohave 6.53%, Paradise Valley 2.51%, Sun City West  
5 2.51%, and Tubac 2.42%).

6           Arizona-American provided evidence that its three-year history of meter replacements  
7 has been 15 years.<sup>119</sup> Staff did not dispute this evidence:

8           Q.     (Mr. Marks) Well, if there had been -- and I don't know the basis for it -- but  
9                 if this comes from the utility plant accounting system, and it's sworn by Ms.  
10                Gutowski that the meters that were replaced in that time period, the average  
11                life was 15 years, do you have any reason to disagree with that?

12          A.     (Ms. Hains) No, I don't have any reason to object that.

13          Mr. Day also testified that Arizona-American strives to replace meters after 15 years, based on  
14 industry standards, the experience of the City of Phoenix, and Arizona-American's meter  
15 testing.<sup>120</sup> For these reasons, the Commission should approve a uniform 6.67% depreciation rate  
16 for water meters.

17          Staff inexplicably lowered the depreciation rate for Mohave Water Mains (accounts  
18 331001, 331100, 331200, and 331300) from what was allowed in the last case, 2.61%, to  
19 1.53%.<sup>121</sup> This would depart from what the Commission recently approved in Decision No.  
20 69440 (May 1, 2007), the last rate case for Mohave Water.<sup>122</sup> Arizona-American and RUCO  
21 used the Commission-approved rate. Because there is no evidence supporting Staff's  
22 recommendation, the Commission should reject this arbitrary change from its previous Decision.

23           **D       RATE CASE EXPENSE (All Districts)**

24           The following table summarizes the parties' recommended rate case expense  
25 recommendations:

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<sup>119</sup> Exhibit A-27 at Exhibit LJJ-2RJ.

<sup>120</sup> Exhibit A-10 at 5.

<sup>121</sup> Exhibit S-3 at Exhibit DMH-3, p. 34, Table 6.

<sup>122</sup> *Id.*

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	Agua Fria Water	Havasu Water	Mohave Water	Paradise Valley Water	Sun City West Water	Tubac Water	Mohave Wastewater
Arizona-American	69,224	4,220	42,941	23,201	25,543	2,240	5,276
Staff	69,224	4,220	24,483	23,201	25,543	2,240	3,181
RUCO	64,012	3,840	23,203	21,283	24,065	2,038	2,981

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Arizona-American's requested rate case expense totals \$517,935 (\$456,275 + \$55,374 + \$6,286) with a three-year amortization period. The portion of Arizona-American's request related to the pending rate application totals \$456,275<sup>123</sup>. In addition, Arizona-American is seeking to recover the remaining unamortized rate case expenses authorized in Decision No. 69440 (May 1, 2007) for Mohave Water and Mohave Wastewater of approximately \$62,000 (\$55,374 for Mohave Water and \$6,286 for Mohave Wastewater), which reflects the balance remaining as of May 31, 2009.<sup>124</sup>

In Staff's Final Schedules, Staff's recommended rate case expense totals \$456,275 which is consistent with Arizona-American's request excluding the unamortized rate case expenses from the last Mohave Water and Mohave Wastewater rate case.

RUCO recommendation was based on the Company's initial request which was subsequently adjusted to remove expenses for witness training and to reallocate the rate case expenses to the districts remaining after the Company revised its application to include seven districts instead of the original 10 districts.

**E GROSS REVENUE CONVERSION FACTOR**

The Parties disagree as to the correct gross revenue conversion factor ("GRCF"). RUCO inexplicably fails to include the property tax factor in its GRCF calculation (1.6286) to provide for property taxes due to the revenue increase.<sup>125</sup> In Arizona-American's last rate case, the Commission considered this issue, and rejected RUCO's position.

<sup>123</sup> Exhibit A-12 at 17:2-3

<sup>124</sup> Exhibit A-29 at 12:22-13:2.

<sup>125</sup> RUCO's Final Schedule RLM-1, p. 2.

1 Staffs proposal regarding inclusion of a property tax factor in its GRCF methodology  
2 in order to calculate the gross revenue required to obtain the proper level of  
3 operating income is reasonable, and will be adopted.<sup>126</sup>

4 The Commission approved a GRCF of 1.6558,<sup>127</sup> which is essentially identical to the 1.6553  
5 GRCF factor used by Arizona-American.<sup>128</sup>

6 Staff's GRCF is 1.651269,<sup>129</sup> which appear to result from using a lower federal tax rate  
7 for Tubac Water, Mohave Water, and Mohave Wastewater.

8 **VI COST OF CAPITAL**

9 **A CAPITAL STRUCTURE**

10 The following table summarizes the parties' recommended capital-structure  
11 recommendations.

	<b>Arizona-American<sup>130</sup></b>	<b>Staff<sup>131</sup></b>	<b>RUCO<sup>132</sup></b>
Short-Term Debt		10.98%	
Long-Term Debt	53.25%	47.70%	55.20%
Equity	46.75%	41.62%	44.8%
Total	100.00%	100.00%	100.00%

12 The primary issue separating the parties is the inclusion of short-term debt in the capital  
13 structure.<sup>133</sup>

14 It is inappropriate to include short-debt in Arizona-American's capital structure.<sup>134</sup> The  
15 amount of Arizona-American's short-term debt has increased due to the on-going construction of  
16 the White Tanks project. This large project is in CWIP and is being financed in the interim by  
17 short-term debt. It is inappropriate to include this short term debt in the Company's permanent

<sup>126</sup> Decision No. 70372, dated June 13, 2008, at 23:1-3.

<sup>127</sup> *Id.* at 33:2.

<sup>128</sup> Arizona-American's Final Schedule A-1.

<sup>129</sup> Staff Final Schedule GWB-2.

<sup>130</sup> Exhibit A-11, at Exhibit TMB-2.

<sup>131</sup> Exhibit S-10, at 2:6-10

<sup>132</sup> Exhibit R-1, at 53:10-13.

<sup>133</sup> Staff's capital structure would be essentially identical to Arizona-American's if short-term debt were excluded

•  $(41.62\%/89.02\%) \times 100 = 46.75\%$  equity.

•  $(47.70\%/89.02\%) \times 100 = 53.6\%$  equity.

<sup>134</sup> This paragraph, Exhibit A-12 at 13:1-5.

1 capital structure when it is financing CWIP, particularly when the associated CWIP is not  
2 included in rate base.

3 If a portion of CWIP is included in rate base, then it would be appropriate to include a  
4 corresponding amount of short-term debt in the capital structure. For example, if the  
5 Commission accepts Arizona-American's proposal to include \$25 million of CWIP in rate base,  
6 then it would be reasonable to include up to that amount in short-term debt in the capital  
7 structure.

8 **B COST OF DEBT**

9 The parties agree that Arizona-American's cost of long-term debt is 5.463%.<sup>135</sup> As  
10 discussed above, Staff inappropriately includes the cost of short-term debt in its cost-of-capital  
11 calculation.

12 **C COST OF EQUITY**

13 The parties' cost-of-equity recommendations follow:

	<b>Arizona-American<sup>136</sup></b>	<b>Staff<sup>137</sup></b>	<b>RUCO<sup>138</sup></b>
Cost of Equity	11.75%	10.0%	8.88%

14 Arizona-American presented its ROE recommendation through the testimony of Dr.  
15 Bente Villadsen, a Principal of The Brattle Group, an economic, environmental and management  
16 consulting firm.<sup>139</sup> At The Brattle Group, Dr. Villadsen's work concentrates on regulatory  
17 finance and accounting matters. Dr. Villadsen holds B.S. and M.S. degrees from the University  
18 of Aarhus, Denmark, and a Ph.D. from Yale University's School of Management.

19 Dr. Villadsen first estimated the overall cost of capital for two samples of regulated  
20 companies using several versions of the discounted cash flow ("DCF") and risk-positioning  
21 models.<sup>140</sup> Second, she determined the cost of equity that the estimated overall cost of capital  
22 gives rise to at Arizona-American's requested capital structure consisting of 46.9% equity.

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<sup>135</sup> Exhibit A-11, at Exhibit TMB-2; Exhibit S-10, at 2:6-10; Exhibit R-1 at Schedule WAR-1, p. 1.

<sup>136</sup> Exhibit A-13, at 3:23 – 4:4.

<sup>137</sup> Exhibit S-10, at 2:13-15

<sup>138</sup> Exhibit R-1, at 4:12-13.

<sup>139</sup> This paragraph, Ex. A-13 at 1:6-12.

<sup>140</sup> This paragraph, Ex. A-13 at 2:15 – 3:4.

1 Third, she evaluated the relative risk of Arizona-American and the sample companies to  
2 determine the recommended cost of equity for Arizona-American.

3 Based on her extensive analysis, Dr. Villadsen testified that Arizona-American's ROE  
4 request of 11.75% was reasonable, because it was equal to the midpoint of her risk-positioning  
5 estimates and below her DCF estimates.<sup>141</sup>

6 Staff's expert witness was David C. Parcell, the President and Senior Economist of  
7 Technical Associates, Inc.<sup>142</sup> RUCO's expert witness was again William A. Rigsby, a Public  
8 Utilities Analyst V.<sup>143</sup>

9 The primary failing of both Staff's and RUCO's recommendations is that they do not  
10 reflect current market conditions. No party disagrees that equity investors must earn more than  
11 debt investors to induce them to invest their funds in a company.<sup>144</sup> Long-term corporate bond  
12 rates have risen significantly, yet neither Staff nor RUCO would provide an adequate incentive  
13 for an investor to purchase equity instead of a safer long-term bond.

14 American Water, Arizona-American's parent, is rated BBB.<sup>145</sup> The current yield on  
15 American Water's recent long-term bonds ranges between 8.5 and 8.6%.<sup>146</sup> These yields are  
16 consistent with current, comparable bond yields. Mr. Parcell testified that the average long-term  
17 BBB bond was yielding nearly 9.0 percent in November and December and still yielding 7.9  
18 percent in January.<sup>147</sup> Mr. Rigsby testified that the most recent Federal Reserve data showed a  
19 yield on BBB rated bonds of 8.4%.<sup>148</sup>

20 Mr. Parcell's allowed return on equity of 10.0% is only 1.4 to 1.5% more than investors  
21 are requiring to invest in American Water's bonds. Because bonds have priority over equity  
22 investments in the event of a bankruptcy, this is not nearly enough of a margin to compensate for

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<sup>141</sup> This paragraph, Ex. A-13 at 3:23 – 4:4.

<sup>142</sup> Exhibit S-10 at 1:3-4.

<sup>143</sup> Exhibit R-1 at 1:3-4.

<sup>144</sup> Tr. at 315:24 – 317:6;

<sup>145</sup> Tr. at 302:17-18.

<sup>146</sup> Tr. at 302:13-15.

<sup>147</sup> Tr. at 378:15-22.

<sup>148</sup> Tr. at 312:16-18.

1 this increased risk, particularly in today's uncertain financial climate. Mr. Rigsby is even more  
2 unrealistic. He acknowledges the high returns being demanded on bond investors, as reported by  
3 the Federal Reserve. Yet, his recommended 8.88% return on equity barely exceeds current bond  
4 returns. No sane investor would buy equity expecting only an 8.88% return, if the alternative  
5 was a bond from the same company yielding 8.5 to 8.6%.

6 A second error shared by Messrs. Parcell and Rigby is their failure to recognize the  
7 increased financial risk to Arizona-American's equity investors because of its more highly  
8 leveraged capital structure. Mr. Parcell agrees in principle that the return on equity should be  
9 adjusted if the financial risk of a company is different than the proxy it is being compared to.<sup>149</sup>  
10 However, even though he calculated a 41.6% equity ratio for Arizona-American, compared to  
11 50% equity ratio for the proxy group he used to calculate his equity cost, he added no risk  
12 premium to account for increased financial risk.<sup>150</sup> This is inconsistent with previous risk  
13 adjustments provided by Staff for Arizona-American and approved by the Commission.<sup>151</sup>

14 In every case until this one where Mr. Rigsby has calculated an equity return for Arizona-  
15 American, he has added 50 basis points to the proxy group's return to compensate Arizona-  
16 American's investors for increased financial risk.<sup>152</sup> This is also the lowest equity return that Mr.  
17 Rigsby has ever calculated for Arizona-American.<sup>153</sup>

18 The Commission should reject the returns on equity recommended by Staff and RUCO.

19 **D COST OF CAPITAL**

20 Based on the evidence and sound theoretical reasoning, Arizona-American's overall cost  
21 of capital is 8.4%.

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<sup>149</sup> Tr. at 365:22 – 368:25.

<sup>150</sup> Tr. at 366:3-6; Exhibit S-11 at 5:14-24.

<sup>151</sup> (Paradise Valley Water - 10.4%) Decision No. 68858 at 26:8-10; 28:26 – 29:3. (Mohave Water and Wastewater - 10.7%) Decision No. 69440 at 18:7-9; 19:9-10. (Sun City West Wastewater and Sun City Wastewater - 10.4%) Decision No. 70209 at 28:27 – 29:10; 30:19-20. (Sun City Water – 10.8%) Decision No. 70351 at 14:16-19; 15:6-7.

<sup>152</sup> Tr. at 308:24 – 310:14.

<sup>153</sup> Tr. at 310:24 – 311:4.

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	<u>Percentage</u>	<u>Cost</u>	<u>Return</u>
Debt	53.25%	5.463%	2.91%
Equity	46.75%	11.75%	5.49
Total			8.40%

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As a check on the reasonableness of this result, Mr. Parcell recently calculated and recommended a cost of capital for Chaparral City Water of 8.8%,<sup>154</sup> 40 basis points more than the amount that Arizona-American is asking for in this case.

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**VII REQUIRED REVENUE INCREASES**

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Based on the evidence in this case, Arizona-American's required revenue increases and related final positions by district are:

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	Agua Fria Water	Havasu Water	Mohave Water	Paradise Valley Water	Sun City West Water	Tubac Water	Mohave Wastewater
Original Cost Rate Base	92,049,310	3,869,261	10,235,260	37,398,279	38,382,791	1,457,349	5,137,269
Adjusted Operating Income	3,016,852	69,904	298,400	2,039,180	736,286	(40,106)	80,377
Current Rate of Return	3.28%	1.81%	2.92%	5.45%	1.92%	(2.75%)	1.56%
Required Operating Income	7,732,142	325,018	859,762	3,141,455	3,224,154	122,417	431,531
Required Rate of Return	8.40%	8.40%	8.40%	8.40%	8.40%	8.40%	8.40%
Operating Income Deficiency	4,715,290	255,113	561,362	1,102,275	2,487,869	162,524	351,154
Gross Revenue Conversion Factor	1.6553	1.6682	1.6807	1.6487	1.6467	1.6648	1.6672
<b>Increase in Gross Revenue Requirement</b>	7,805,169	425,579	943,485	1,817,267	4,096,767	275,575	585,459
Adjusted Test Year Revenue	18,818,613	1,177,522	5,113,631	8,220,586	5,857,266	426,900	796,161
Proposed Annual Revenue	26,623,782	1,603,101	6,057,116	10,037,853	9,954,033	697,475	1,381,620

<sup>154</sup> Exhibit A-17 at 12:20-26.

1 **VIII RATE DESIGN**

2 **A GENERAL RATE DESIGN**

3 Arizona-American, Staff, and RUCO seem to be in general agreement on the appropriate  
4 rate design for the seven districts.

5 **B RATE CONSOLIDATION**

6 **1 General Discussion**

7 On November 12, 2008, (then) Commissioner Mayes wrote a letter to the parties in this  
8 docket, which asked (in part): "I write to request that the Parties provide the Commission, as part  
9 of their testimony in this case, an analysis addressing the predicted impacts of statewide and  
10 select consolidation of Arizona-American's water systems."

11 Arizona-American responded to Chairman Mayes' request by offering a rate  
12 consolidation tool and the results of one specific scenario.<sup>155</sup> The consolidation-analysis tool is a  
13 large Excel spreadsheet, which was made available to every party. Alternatively, a party could  
14 obtain results by submitting a data request to Arizona-American specifying the desired  
15 assumptions. Arizona-American provided the results of one specific rate consolidation scenario  
16 for the residential class of customers for all of Arizona-American's eight water districts.<sup>156</sup>

17 Mr. Townsley stated that Arizona-American conditionally supported rate consolidation  
18 for a number of reasons.<sup>157</sup> These reasons included improved rate case efficiency, improving  
19 ability to make needed capital investments in smaller districts without imposing burdensome rate  
20 increases, improving ability to acquire small troubled water systems, and a desire to bring the  
21 tariff structure of water and wastewater utilities more in line with those of other regulated  
22 utilities in Arizona, that all support consolidation on a philosophical basis.

23 However, Mr. Townsley also had some concerns with rate consolidation.<sup>158</sup> The  
24 practicalities of district consolidation present significant challenges to both the Commission and

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<sup>155</sup> This paragraph, Exhibit A-12 at 5:8-16.

<sup>156</sup> Exhibit A-12 at Exhibit TMB-R4 (Exhibit TMB-R4 is located at the end of Exhibit A-12. but is not labeled).

<sup>157</sup> This paragraph, Exhibit A-19 at 12:1-6.

<sup>158</sup> This paragraph, Exhibit A-19 at 16:3-16.

1 Arizona-American. For instance, average customer water bills across Arizona-American's  
2 systems range from about \$12 per month in Sun City to about \$70 per month in Paradise Valley.  
3 While some of this disparity is due to differences in customer consumption levels, it is also due  
4 to differences in net-plant investment and O&M expense per customer between districts.  
5 Proposals for rate consolidation in the short term are likely to cause significant public and  
6 political consternation. Arizona-American could not support consolidation if the result were to  
7 delay rate relief, or otherwise harm the Company.

8 Staff also conditionally supported rate consolidation in a future proceeding.<sup>159</sup> However,  
9 Staff was concerned about unintentional consequences resulting from rushing into  
10 consolidation.<sup>160</sup> Staff also recognized that a great deal of work remained before rates could be  
11 consolidated for Arizona-American. Specific issues included:<sup>161</sup>

- 12 1. How to deal with different numbers of, and break points for, rate tiers across the  
13 districts.
- 14 2. How to account for differing uses of water for irrigation in different districts,  
15 particularly in the Paradise Valley Water District.
- 16 3. Whether to consolidate commercial rates at the same time.
- 17 4. Whether returns on customer classes as a result of cost of service studies are or  
18 should be the same in the different districts.
- 19 5. How to maximize public input, including whether to hold workshops.
- 20 6. How to educate the public about the pros and cons of rate consolidation.
- 21 7. How Staff, RUCO, and other parties would participate in the public process.
- 22 8. Whether to flash cut to consolidated rates or to phase them in.
- 23 9. Whether to consolidate sewer rates at the same time that water rates are consolidated.
- 24 10. What economies of scale would result from consolidation.

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<sup>159</sup> Exhibit S-16 at 3:16-20.

<sup>160</sup> Exhibit S-16 at 4:5-6.

<sup>161</sup> Tr. at 892:5 – 897:14.

1                                   **2           Arizona-American’s Position**

2           Because of the many complexities and the strong potential for unintended consequences,  
3 Arizona-American rate consolidation must be analyzed through a separate proceeding focusing  
4 solely on the issues surrounding consolidation. To address consolidation, Arizona-American  
5 intends to do the following as a separate (nearly) parallel process with its next rate case (“next  
6 Rate Case”):

- 7           1. Open a separate docket including all of its districts focusing solely on rate consolidation  
8           (“Rate Consolidation Docket”).
- 9           2. At the appropriate time, Arizona-American will request that the Commission re-open the  
10           2008 Rate Case docket and the next Rate Case docket pursuant to A.R.S. § 40-252, solely  
11           for the purpose of re-examining the rate design consistent with the resolution of the Rate  
12           Consolidation Docket.
- 13           3. If a new rate design is ordered as part of the Rate Consolidation Docket, the A.R.S. § 40-  
14           252 procedure would allow the final order in the 2008 Rate Case and the final order in  
15           the next Rate Case to be amended solely to adjust rate design.
- 16           4. The Commission must rely on the summation of the individual districts’ revenue  
17           requirements found in the 2008 Rate Case Order and in the next Rate Case Decision as a  
18           basis for a new rate design consolidating rates in some or all districts.
- 19           5. This procedure would allow the Commission to fully examine rate consolidation while at  
20           the same time allow Arizona-American to implement new rates in each of its districts on  
21           an unconsolidated basis, which is necessary in the interim to ensure Arizona-American’s  
22           continued financial health and stability.
- 23           6. Arizona-American is willing to support the above actions as best as possible in a manner  
24           consistent with completion of the next Rate Case and rate consolidation by December  
25           2010. However, Arizona-American can only control the timing of initial application  
26           filings; it has only limited influence on subsequent procedural dates.

1                                   **3     Reply to Mr. Magruder**

2                   Mr. Magruder asks the Commission to order rate consolidation for the six water districts  
3 in this case as part of the Commission’s final order.<sup>162</sup> For the reasons given above, this would  
4 be impractical, could delay this case, and could lead to unintended consequences. At this time,  
5 there are more questions than answers. To answer these questions, data must be gathered,  
6 informed public input must be received, and difficult policy choices must be made. As proposed  
7 above, a subsequent, parallel proceeding is needed to provide a forum for all parties, the public  
8 and the Commission to consider consolidation.

9                   **C     TUBAC RATE DESIGN**

10                  For the Tubac Water District, Mr. Magruder proposes many more rate blocks, with severe  
11 inverted block rates.<sup>163</sup> Arizona-American opposes Mr. Magruder’s proposals and will respond  
12 further in its reply brief.

13 **IX     OTHER ISSUES**

14                   **A     TUBAC WATER ACRM**

15                  Arizona-American must provide arsenic treatment for its Tubac Water customers.<sup>164</sup>  
16 Arizona-American is currently designing an arsenic treatment facility at Water Plant No.5, which  
17 should be in service by summer 2010.<sup>165</sup> Arizona-American asks the Commission to approve an  
18 Arsenic Cost Recovery Mechanism (“ACRM”) for Tubac Water that is essentially identical to  
19 the ACRMs previously approved for Arizona-American’s Agua Fria Water, Havasu Water,  
20 Paradise Valley Water, and Sun City Water districts.<sup>166</sup>

21                  Staff and RUCO support Arizona-American’s request. Mr. Magruder opposes it because  
22 he believes that a point-of-use system would be preferable.<sup>167</sup> However, although a point-of-use  
23 system would be initially less expensive, it would be more expensive in the long run.<sup>168</sup> Further,

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<sup>162</sup> Tr. at 909:5-21.

<sup>163</sup> Exhibit M-4 at 10:28-11:10.

<sup>164</sup> Exhibit A-1 at 8:6-10.

<sup>165</sup> Exhibit A-2 at 9:20-21.

<sup>166</sup> Exhibit A-11 at 25:10-21.

<sup>167</sup> Exhibit M-4 at 15:23-24.

<sup>168</sup> Exhibit A-9 at 3:4 – 4:10.

1 the central plant option treats all water used in a home, but the point-of-use option would treat  
2 only water provided for through a spigot at the kitchen sink.<sup>169</sup> Finally, to ensure compliance,  
3 Arizona-American would have to regularly enter every customer residence or business to test the  
4 systems and to replace filters. This would not only be a burden on Arizona-American, but also on  
5 our customers.<sup>170</sup>

6 **B PARADISE VALLEY WATER CAP SURCHARGE CHANGES**

7 As more fully described in Exhibit A-22, Arizona-American proposes to modify its  
8 current CAP surcharge for the Paradise Valley Water District to account for changes in water  
9 supply and storage.<sup>171</sup> No party opposes this change.

10 **C POWER SUPPLY ADJUSTER**

11 Arizona-American hereby withdraws its request that the Commission approve a power  
12 supply adjustor for its water districts.

13 **D WATER LOSSES**

14 Arizona-American and Staff agree that water losses should be reduced below ten percent.  
15 Water losses for Havasu Water and Mohave Water's Bullhead City system currently exceed this  
16 target.<sup>172</sup> Arizona-American does not support Staff's recommended consequences for not  
17 reducing water losses below ten percent.<sup>173</sup>

18 Arizona-American should not be precluded from submitting any applications at the  
19 Commission based on water-loss percentages exceeding ten percent (or any percentage for that  
20 matter) as a form of punishment of Arizona-American.<sup>174</sup> Rather, it would make much more  
21 sense to require Arizona-American and Staff to work cooperatively together to derive a plan to  
22 further reduce water loss with the cost of the plan made transparent to all.

23 If the consequence of somewhat higher water losses for a district would be no rate relief,  
24 Arizona-American could be forced to cancel or defer other worthwhile capital projects in favor

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<sup>169</sup> *Id.* at 4:11-15.

<sup>170</sup> *Id.* at 5:2-5.

<sup>171</sup> Exhibit A-21 at 6:17-9:8.

<sup>172</sup> Exhibit S-3 at 6:14-16; 7:25-26.

<sup>173</sup> Exhibit S-3 at 6:15-24; 7:26 – 8:9.

<sup>174</sup> This paragraph, Exhibit A-12 at 15:16-21.

1 of addressing water losses.<sup>175</sup> Water losses can be reduced, but at a cost. Arizona-American has  
2 various on-going meter and other infrastructure replacement programs that, if appropriate, might  
3 be accelerated or augmented. But, these programs must compete in these difficult economic  
4 times with other worthy investments. It makes no sense to essentially force investment in one  
5 area, without examining all possible challenges and opportunities.

6 **E TUBAC WELL DRILLING**

7 Mr. Magruder claims that Arizona-American is not complying with A.R.S. 945-454c  
8 concerning the drilling of exempt wells.<sup>176</sup> Mr. Magruder is incorrect. This provision does not  
9 apply to Arizona-American's Tubac Water District.<sup>177</sup>

10 The referenced statute does disallow exempt wells within the lands served by a municipal  
11 provider with an assured water supply designation.<sup>178</sup> However, although Arizona-American's  
12 Tubac Water District is considered to be a municipal provider, it has not received an assured  
13 water supply designation. Instead, it is the responsibility of each developer to obtain a certificate  
14 of assured water supply. Therefore, the statute does not allow Arizona-American to prevent  
15 exempt wells in its service area.

16 **X CONCLUSION**

17 For the reasons given above, the Commission should approve Arizona-American's  
18 requested rate increases. This will be another badly needed step toward financial recovery.

19 RESPECTFULLY SUBMITTED on May 1, 2009.

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<sup>175</sup> This paragraph, Exhibit A-12 at 15:23 – 16:5.

<sup>176</sup> Exhibit M-5 at 11:12-16.

<sup>177</sup> Exhibit A-22 at 1:19.

<sup>178</sup> This paragraph, Exhibit A-22 at 2:8-18.