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BEFORE THE ARIZONA CORPORATION COMMISSION

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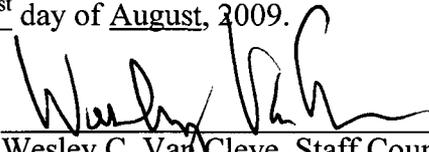
6 IN THE MATTER OF THE APPLICATION OF  
 7 ARIZONA WATER COMPANY, AN  
 8 ARIZONA CORPORATION, FOR A  
 9 DETERMINATION OF THE FAIR VALUE OF  
 10 ITS UTILITY PLANT AND PROPERTY, AND  
 FOR ADJUSTMENTS TO ITS RATES AND  
 CHARGES FOR UTILITY SERVICE AND  
 FOR CERTAIN RELATED APPROVALS  
 BASED THEREON.

DOCKET NO. W-01445A-08-0440

**STAFF'S NOTICE OF FILING**

11 Staff of the Arizona Corporation Commission hereby provides notice of filing the Summary  
 12 of Witness Testimonies of Elijah O. Abinah, Steve M. Olea, Alexander I. Igwe, Brian K. Bozzo,  
 13 David C. Parcell, Jeffery Michlik, and Katrin Stukov in the above-referenced matter.

RESPECTFULLY SUBMITTED this 31<sup>st</sup> day of August, 2009.

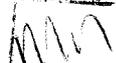
  
 \_\_\_\_\_  
 Wesley C. VanCleve, Staff Counsel  
 Ayesha Vohra, Staff Counsel  
 Legal Division  
 Arizona Corporation Commission  
 1200 West Washington Street  
 Phoenix, Arizona 85007  
 (602) 542-3402

21 Original and thirteen (13) copies  
 22 of the foregoing were filed this  
 31<sup>st</sup> day of August, 2009 with:

23 Docket Control  
 24 Arizona Corporation Commission  
 1200 West Washington Street  
 Phoenix, Arizona 85007

Arizona Corporation Commission  
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AUG 31 2009

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1 Copy of the foregoing mailed this  
2 31<sup>st</sup> day of August, 2009 to:

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29 Roseann Osorio

**WITNESS SUMMARY OF  
ELIJAH ABINAH  
ARIZONA WATER COMPANY  
DOCKET NO. W-01445A-08-0440**

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Staff believes where and when it is technically and financially feasible, rate consolidation and system interconnections should be considered by the Arizona Corporation Commission ("Commission").

Staff recommends that the Commission approve Arizona Water Company's ("Company") proposed rate consolidation with some modifications. Staff further recommends that the Company file in this docket, as a compliance item, a detailed timeline by which the Company will achieve interconnection of its systems where it is technically and financially feasible. In addition, the Company should also file in this docket, as a compliance item, a plan/timeline by which the Company will achieve a single rate structure for its entire systems.

**STEVEN M. OLEA - STAFF WITNESS SUMMARY  
ARIZONA WATER COMPANY, FOR A DETERMINATION  
OF THE FAIR VALUE OF ITS UTILITY PLANT  
AND PROPERTY, AND FOR ADJUSTMENTS  
TO ITS RATES AND CHARGES FOR UTILITY  
SERVICE AND FOR CERTAIN RELATED  
APPROVALS BASED THEREON  
(DOCKET NO. W-01445A-08-0440)**

Staff Witness Olea's purpose/assignment in the Arizona Water Company ("Company") rate case was to review the Cost of Service Study ("COSS") and to present the results of that review.

In the course of the review, Staff Witness Olea found the Company's use of the Commodity-Demand Method in this case to be appropriate.

Staff is in agreement with the allocation factors used by Arizona Water Company except for those involving General Plant, Water Treatment Expenses, and Transmission & Distribution Expenses.

**SUMMARY OF TESTIMONY OF  
ALEXANDER IBHADE IGWE, CPA  
FOR ARIZONA WATER COMPANY  
DOCKET NO. W-01445A-08-0440**

**OUTSTANDING ISSUES**

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**GENERAL ISSUES**

Adjuster Mechanisms/Attrition Adjuster Mechanism

Staff continues to recommend denial of the Company's existing and proposed adjuster mechanisms or an attrition adjuster mechanism. The Company has not provided any justification for deviating from the Commission findings in Decision Nos. 66849 and 68302

**New ACRM**

Staff's recommendation regarding approval of new ACRM for Sedona and Superstition systems is consistent with the Company's request in this filing. This recommendation does not preclude the Company from seeking recovery of prudently incurred arsenic remediation costs for its other water systems.

**OPERATING EXPENSES**

Transmission and Distribution Expenses

**Tank Maintenance**

Staff continues to recommend a normalized level of tank maintenance expense for the Company. Staff's recommended tank maintenance expense is reasonable, and more appropriate reflects the Company's actual cost of tank maintenance expense over the last seven years. Also, Staff continues to recommend rejection of the Company's requested accrual account for tank maintenance. The Company's requested tank maintenance accrual account significantly shifts the risk of cost variability from the shareholders to the ratepayers.

**Transmission and Distribution Expenses – Meters and Mains**

For Superstition and Casa Grande, Staff continues to recommend normalizing test year cost for transmission and distribution-subaccounts 663 and 673. Staff's recommendation eliminates abnormal spike in test year costs over 2005 and 2006 levels.

Pumping Expense

For the Superstition system only, Staff recommends a normalized level of pipeline maintenance expense of \$53,529, in lieu of the Company's requested Desert Well Pump Maintenance Accrual Account. If the Commission approves the Company's requested accrual account, it significant shifts any risk of cost variability to ratepayers, without a corresponding decrease in cost of equity.

General Administration Expense

Staff continues to recommend denial of the Company's proposed conservation adjustment for the Northern Group. The Company has not demonstrated why it should be granted this extraordinary relief in cost of service.

### Depreciation and Amortization

Staff continues to recommend amortization of CIAC balances based on each system's weighted average depreciation rate for each plant account t. If the Company advocates the use of component amortization rate for its test year CIAC balances, it has the responsibility of identifying the related plant account balances per system. The Company has been unable breakout its CIAC balance per plant account per each system.

**BRIAN K. BOZZO - STAFF WITNESS SUMMARY  
ARIZONA WATER COMPANY, FOR A DETERMINATION  
OF THE FAIR VALUE OF ITS UTILITY PLANT  
AND PROPERTY, AND FOR ADJUSTMENTS  
TO ITS RATES AND CHARGES FOR UTILITY  
SERVICE AND FOR CERTAIN RELATED  
APPROVALS BASED THEREON  
(DOCKET NO. W-01445A-08-0440)**

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Arizona Water Company, Inc. ("AWC") is a public service corporation engaged in the business of providing public utility water service to approximately 83,809 Arizona customers. On August 22, 2008, Arizona Water Company ("AWC" or "Company") docketed an application for a determination of the fair value of its utility plant and property and for an adjustment to its rate and charges for seventeen (17) individual "districts" within its Company.

The purpose of my testimony in this proceeding was to present Staff's analysis and recommendations concerning the Company's Rate Base for each system or district in this docket. Currently, the remaining issues between Staff and the Company relate first, to Staff's "Not Used and Useful Plant" disallowances which were distilled by the Company into the "currently in use", "needs to be retired" and "plant held for future use" arguments; and second, the working capital issue in which Staff recommends that the cost of equity not be included as a component of the Company lead-lag study.

Not Used and Useful Plant

The Company itself provided information to Staff confirming that certain Company plant items were inappropriately included in plant in service and therefore rate base. Staff therefore determined that those items were "Not Used and Useful" plant and recommended their disallowance. Only after Staff's disallowance of those items did AWC then separate those plant items into subsequent categories of plant ("currently in use", "needs to be retired" and "plant held for future use").

Currently in Use

Staff recommends the disallowance of these plant items based on information provided by the Company that the items were not providing service to customers. With the possible exception of several items for which Staff seeks additional clarity, these items are not providing direct benefit to ratepayers and should not be included in rate base.

### Needs to be Retired

Staff continues to recommend the removal from plant in service of the plant items the Company has re-categorized as “needs to be retired”. This plant was not retired in the Test Year, nor removed via pro forma adjustment, nor even retired prior to Staff’s inspection of plant. According to the Company, this plant was only recently retired in August 2009. This is plant that was originally included in plant in service and was only identified for retirement after Staff’s plant disallowance in this case. Considering the August 2009 retirement dates, these transactions were executed too far outside the December 31, 2009 Test Year to be appropriately recognized in this case.

### Plant Held For Future Use

Staff continues to recommend the removal from plant in service of the plant items the Company has re-categorized as “plant held for future use”. The Company’s “Plant Held For Future Use” items are a subset of the plant included in Staff’s “Not Used and Useful” disallowance. However, these plant items are not actually “Plant Held For Future Use”. In his rejoinder testimony, Mr. Reiker stated that the plant in this category has not been transferred into the “Plant Held For Future Use” account. Therefore this plant is currently classified as plant in service, the same classification it held when Staff initially disallowed the plant. Additionally, even if transferred, plant in the “Plant Held For Future Use” account is not historically recognized for ratemaking purposes. Staff testified that such plant is not appropriate for inclusion in rate base because it is not used and useful.

### Working Capital

Staff continues to recommend the removal of the cost of equity component from the determination of working capital. The cost of equity is not a normal or appropriate component for inclusion in a lead-lag study. The cost of debt, however, is a known and measurable item of expense similar to the other cost components included in the lead-lag study. Staff’s inclusion of the cost of debt, either historically or in this case, does not appropriately lead to including the cost of equity. The cost of equity is not a certain debt or obligation in that it does not have to be paid or does not have to be paid in a certain amount.

**TESTIMONY SUMMARY OF DAVID C. PARCELL  
ON BEHALF OF UTILITIES DIVISION STAFF  
APPLICATION OF ARIZONA WATER COMPANY  
DOCKET NO. W-01445A-08-0440  
SUBJECT: COST OF CAPITAL**

My direct testimony provides my estimate of the cost of capital for Arizona Water. My cost of capital recommendation is as follows:

	<u>Percent</u>	<u>Cost</u>	<u>Return</u>
Short-term Debt	4.80%	3.00%	0.14%
Long-term Debt	49.35%	6.83%	3.37%
Common Equity	<u>45.85%</u>	9.5 – 10.5%	<u>4.36 – 4.81%</u>
Total Capital	100.00%		7.87 – 8.33%
			8.10% Mid-point

There are several differences between my 8.10 percent recommendation and the 9.81 percent cost of capital request of the Company. First, Arizona Water proposes to use an adjusted December 31, 2007 capital structure, where as I use an actual December 31, 2008 capital structure. Second, I include short-term debt in my capital structure, as is this Commission's normal practice. Third, I use an actual December 31, cost of long-term debt, whereas the Company uses a projected December 31, 2007 cost rate. Finally, I propose a cost of equity of 10.0 percent and Arizona Water requests a cost of equity of 12.4 percent.

My 10.0 percent cost of common equity is derived from my application of three cost of equity models:

Discounted Flow	9.5 – 10.5%
Capital Asset Pricing Model	8.2 – 8.6%
Comparable Earnings	9.5 – 10.5%

My direct testimony also addresses the cost of capital testimony of Arizona Water witness Thomas M. Zepp. In my direct testimony, I note that Dr. Zepp's cost of equity analyses over-state the cost of equity for Arizona Water.

My surrebuttal testimony addresses the rebuttal testimony of Arizona Water witness Zepp. In this, I respond to Dr. Zepp's criticisms of my direct testimony. I continue to maintain that my cost of equity recommendation is appropriate at this time for Arizona Water.

**WITNESS SUMMARY OF  
JEFF MICHLIK  
ARIZONA WATER COMPANY  
DOCKET NO. W-01445A-08-0440**

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The testimony of Mr. Michlik addresses the following outstanding issues:

**Rate Design**

System Consolidations – Staff continues to recommend full consolidation of all the systems that the Company recommended for full or partial consolidation, except for Sedona/Stansfield/Coolidge (Stansfield will have higher tiered rates – commodity rates than the other two systems) and Sierra Vista and Bisbee will have different commodity rates.

Rate Design for all Customers – Staff continues to recommend charging the same monthly service charge and commodity rates to all customer classes as well as implementing an inverted-tier rate design for all customers, in accordance with the proposed consolidation, which reflect the value of water as a finite resource

Inverted-Tier Rates – Staff explains the rationale for proposing inverted-tier rates.

Typical Bill Analysis – Staff explains the components and presentation of a typical bill analysis.

Elimination of Monthly Service Charge for Construction Water and Resale Water – Staff explains the rationale for proposing the elimination of the monthly service charge for construction water customers and water resale customers.

**WITNESS SUMMARY OF  
KATRIN STUKOV  
FOR ARIZONA WATER COMPANY  
DOCKET NO. W-01445A-08-0440**

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**CONCLUSIONS**

1. The Arizona Department of Environmental Quality (“ADEQ”) or its formally delegated agent, the Maricopa County Environmental Services Department (“MCESD”), has reported that all Arizona Water Company community water systems have no deficiencies and these systems are currently delivering water that meets water quality standards required by Arizona Administrative Code, Title 18, and Chapter 4.
2. The Forest Towne water system is not a community system and is not subject to ADEQ or Arizona Department of Water Resources (“ADWR”) Compliance monitoring.
3. Eight of the Company’s systems have a water loss above the recommended threshold amount of 10 percent. By system, the water loss is as follows: Pinetop Lakes, 15.4 percent; Pinewood, 26 percent; Rimrock, 11 percent; Superior, 18.4 percent; Winkelman, 12 percent; San Manuel, 10.7 percent; Bisbee, 16 percent; and Tierra Grande, 12.6 percent.
4. All Arizona Water Company (“AWC” or “Company”) water systems have adequate storage capacities to serve their respective present customer base and a reasonable level of growth.
5. Except for the Valley Vista system, all other AWC water systems have adequate production capacities to serve their respective present customer base and a reasonable level of growth.
6. ADWR has determined that, except for Superior and Oracle, the Company’s other water systems are in compliance with ADWR requirements governing community water systems.
7. ADWR has determined that Management Plans filed for Superior and Oracle systems are not in compliance with ADWR requirements with regard to potential Lost and Unaccounted for Water (“L&U”) violations.
8. The Company has approved curtailment plan and a backflow prevention tariffs.

## RECOMMENDATIONS

1. Eight of the Company's systems (Pinetop Lakes, Pinewood, Rimrock, Superior, Winkelman, San Manuel, Bisbee and Tierra Grande) have a water loss above the recommended threshold amount of 10 percent. Staff recommends that the Company evaluate these water systems and prepare a report for corrective measures demonstrating how the Company will reduce water losses to less than 10 percent. Water loss shall be reduced to less than 10 percent by December 31, 2010. If the Company finds that reduction of water loss to less than 10 percent is not cost-effective, the Company shall submit a detailed cost analysis and explanation demonstrating why the water loss reduction to less than 10 percent is not cost effective. In no case shall water loss be allowed to remain above 15 percent. The Company shall file the corrective measures or cost effectiveness report with Docket Control, as a compliance item in this docket, by June 30, 2011.
2. Staff recommends that the Company file as a compliance item in this docket, no later than December 31, 2010, the documentation issued by ADWR indicating that the Company's Superior and Oracle systems Management Plans have met ADWR requirements.
3. Staff recommends that the Company file with Docket Control, as a compliance item in this docket, copies of the Approval of Construction issued by ADEQ for the proposed Arsenic Treatment Plant for the Valley Vista water system's well #55-212110 by May 31, 2010.
4. Staff recommends that the Company's reported annual water testing expense of \$65,459 (which excludes the MAP expense of \$66,992) be accepted for this proceeding.
5. Staff recommends the adoption of the previously approved depreciation rates developed by the Company in this company-wide rate case, as presented in Table A.
6. Staff recommends the acceptance of the Company's requested service line and meter installation charges, as delineated in Table B.
7. Staff recommends that in case any of the Company's water systems should be consolidated for purpose of rate making and accounting, AWC be required to continue reporting the information, including, but not limited to Water Use and Plant Description Data, separately for each of its individual systems by PWS, as defined by ADEQ, in future Annual Reports and rate filings.