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BEFORE THE 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 ANTHEM WATER DISTRICT AND ITS SUN CITY WATER DISTRICT.

DOCKET NO. W-01303A-09-0343

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 ANTHEM/AGUA FRIA WASTEWATER DISTRICT, ITS SUN CITY WASTEWATER DISTRICT AND ITS SUN CITY WEST WASTEWATER DISTRICT.

DOCKET NO. SW-01303A-09-0343

REPLY BRIEF OF THE COMMISSION STAFF

Arizona Corporation Commission

DOCKETED

AUG 6 2010

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I. INTRODUCTION.

Staff hereby responds to the Initial Post-Hearing Briefs filed by Arizona-American Water Company ("Company" or "Arizona-American"), the Anthem Community Council ("the Council"), Corte Bella, DMB White Tank, LLC ("DMB White Tank"), Marshall Magruder, the Town of Paradise Valley ("Paradise Valley"), the Resorts, and the Residential Utility Consumers Office ("RUCO").

Staff failure to respond to all of the arguments raised by the other parties should not imply agreement with those arguments. To the extent that Staff has addressed an issue in its Initial Brief and there are no new arguments raised, Staff will not simply repeat the arguments contained in its Initial Brief. However, Staff's silence on an issue should not be construed as

1 agreement unless Staff has specifically stated its agreement with the particular issue in its
2 testimony or Initial Brief.

3 As the parties' Initial Briefs demonstrate, there are many issues in dispute yet in this case.
4 Two of the most difficult issues the parties have grappled with in this proceeding relate to the
5 appropriate level of rate increase in this case particularly for the Anthem Water District and the
6 Anthem/Agua Fria Wastewater District and whether the Commission should adopt a
7 consolidated rate design for any or all of the Company's Arizona Districts.

8 **II. DISCUSSION.**

9 The Company has worked to resolve many of the issues in dispute with Staff. The
10 Company has accepted Staff's position on cost of capital and return on equity; the accounting
11 treatment of the Glendale Agreement; allocation of the Northwest Valley Treatment Plant; and
12 accounting treatment of the costs associated with Tank Maintenance in its Sun City Water
13 District.

14 Important issues still remain in dispute between Staff and the Company and Staff responds
15 below to new arguments (not addressed in Staff's Initial Post-Hearing Brief) raised by the
16 Company on certain issues. Staff also responds to any new arguments posed by other parties that
17 were not addressed in its Initial Brief.

18 **A. Phase I Revenue Requirement Issues.**

19 **1. Cash working capital.**

20 The Company continues to disagree with the Staff recommendation on the calculation of the
21 expense lag days related to the payment of management fees to the Company's affiliate, Service
22 Company. Contrary to the assertions by the Company that Staff's removal indicated uncertainty as to
23 the treatment of the lag days,¹ Staff still maintains that is inappropriate to use an internal agreement
24 regarding the timing of the payment of management fees between the Company and its unregulated
25 affiliate, to calculate the lead/lag days. Were the Service Company not an affiliate, the procurement
26 and payment for services would be at 'arm's length' and might be more commercially reasonable.
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¹ Company's Closing Br. at 15.

1 The Company's internal arrangement should not dictate its need for cash working capital. Staff is still
2 concerned that the terms of that arrangement could change to one of more prepayment of
3 management fees. Staff continues to recommend that the effects of the 14.77 lag days for
4 Management expenses (the original lag days requested by the Company) be excluded and the 11 lead
5 days be disregarded.²

6 **2. Allocation of the Northwest Valley Regional Water Reclamation Facility between**
7 **the Anthem/Agua Fria Wastewater District and the Sun City West Wastewater**
8 **District.**

9 The Council continues to argue for a revision to the allocation of the Northwest Valley
10 Treatment Plant.³ Staff has recommended that 28 percent be allocated to Anthem/Agua Fria
11 Wastewater and 72 percent be allocated to Sun City West Wastewater. The analysis performed by
12 Staff to project growth for the allocation percentage has been used consistently by Staff and adopted
13 by the Commission. The method used by the Council to arrive at its growth projections is flawed and
14 should be rejected.

15 In performing his growth analysis, Council witness Dan Neidlinger completely disregarded
16 the customer counts for the years 2005 and 2006 stating that it would be unrealistic to count that
17 since it doesn't come close to representing what is going to happen in the future in the area."⁴ When
18 asked by Judge Wolfe how he knows what would happen in the future, Mr. Neidlinger insisted that
19 the growth could not be 704 customers a year.⁵ By disregarding the customer counts for the years
20 2005 and 2006, the Council's method does not give an accurate portrayal of growth in the area. The
21 Council's methodology would result in a skewed allocation. Staff's recommendation has been
22 accepted by RUCO and the Company and should be adopted in this case.

23 **3. Glendale Interceptor (Sun City Wastewater).**

24 Staff continues to recommend that the amounts paid by the Company under its agreement
25 with the City of Glendale to use the 99th Avenue interceptor for sewer transport be treated as a capital
26 lease and should be included in rate base for the Sun City Wastewater District. Staff further

27 ² Becker Surrebuttal (Ex. S-10) at 6; McMurry Surrebuttal (Ex. S-6) at 5.

28 ³ Council Closing Br. at 12-13.

⁴ Tr. Phase I at 873:2-10

⁵ *Id.*

1 recommended denial of the Company's request for a deferral order. In its brief, the Company appears
2 to indicate the acceptance of the Staff recommendation by making the request to included \$917,906
3 of replacement costs, net of depreciation, into rated base as shown in its final schedules.

4 **4. Pension expense.**

5 Staff made no adjustment to the Company's request for pension expense. Staff's treatment of
6 the expense is consistent with its treatment in the prior Arizona-American rate case. However, the
7 Company and RUCO disagree. The Company has requested pension expense amounts based on the
8 average of the Company's 2009 and 2010 ERISA funding payment.⁶ RUCO recommends using the
9 2008 FAS 87 amount as a reasonable allowance for pension expense.⁷ RUCO has also recommended
10 that the Commission approve the FAS 87 accounting treatment over the ERISA method.⁸

11 As Company witness Tom Broderick testified, that the Company is not seeking to transition
12 to FAS 87 on a permanent basis and believes that more evidence would need to be provided. Staff,
13 also has concerns that a full record regarding the costs to transition from ERISA to FAS 87 has not
14 been developed.

15 **5. Rate case expense.**

16 In its calculation of rate case expense, the Company included \$12,500 for its "Expected
17 Unamortized Balance as of 9/2010" of \$37,500 to be recovered over three years, along with the
18 estimated rate case expense of the instant proceeding. Staff witnesses Gerald Becker and Gary
19 McMurry, consistent with prior Commission decisions, recommended the exclusion of unrecovered
20 rate case expense related to prior proceedings, consistent with prior Commission decisions.⁹
21 Company witness Miles Kiger accepted Staff's adjustments regarding the removal or prior approved
22 rate case expense.¹⁰ Staff made no further adjustments to the Company's proposal for rate case
23 expense.

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27 ⁶ Kiger Rebuttal (Ex A-14) at 14-15.

28 ⁷ RUCO Final Accounting Schedule RCS-6, C-5 at 1.

⁸ RUCO Closing Br. at 15.

⁹ Becker Direct (Ex. S-9) at 37.

¹⁰ Kiger Rebuttal (Ex. A-14) at 17.

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6. Anthem refunds.

The Council relies upon its Pre-Hearing Memorandum to advance its position that the Commission “should (i) permanently exclude from AAWC’s rate base, and (ii) deny any associated ratemaking recognition of the Disputed Refund Payments relevant to this rate case because the Infrastructure Agreement has never been fully approved by the Commission as required by Arizona law and by the express provisions of the Infrastructure Agreement itself.”¹¹ In its Pre-Hearing Memorandum, the Council argues that the Infrastructure Agreement was required to be approved by the Commission because it constitutes “other evidence of indebtedness” under A.R.S. § 40-301 *et. seq.* It also believes that the Infrastructure Agreement was subject to approval under A.A.C. R14-2-406 as a main extension agreement. Because the Agreement was never approved under either provision, the Council believes this provides a basis for complete disallowance.

In Staff’s Initial Brief, Staff outlined why it believed that the Council’s legal theories for total exclusion of the Pulte refunds were flawed and would be inequitable to the Company. First, Staff does not believe that the agreements are “an evidence of indebtedness” such that they would fall within the provisions of A.R.S. § 40-301 *et seq.* requiring prior Commission approval. While the Council would use the Company’s failure to obtain Commission approval under A.R.S. § 40-301 to permanently exclude the full amount of the refund payments from rate base, it does not explain how it reconciles this with the fact that the Company sought Commission approval on several occasions but was unsuccessful in obtaining it.¹² Moreover, the Company is correct that if the Commission were to adopt the Council’s interpretation of A.R.S. §§ 301 *et seq.* then “nearly every existing main extension and line extension agreement in the state would become invalid”.¹³ Further under the Council’s interpretation, the Commission would suddenly become inundated with agreements that could potentially qualify as “other evidences of

¹¹ Council’s Closing Br. at p. 4.
¹² Company’ Closing Br. at 22.
¹³ Company’s Closing Br. at 24.

1 indebtedness.” “[A] two-year contract with an office cleaning company would require
2 approval as an evidence of indebtedness.”¹⁴

3 The Council’s second legal argument for permanently excluding the amount of the Pulte
4 refunds from rate base is equally flawed. A.A.C. 14-2-406 requires Staff approval of main
5 extension agreements between water companies and developers. The failure to obtain approval
6 results in the refundable advance being immediately due and payable to the person making the
7 advance. First, the agreements at issue were not simply main extension agreements but went
8 well beyond this sort of agreement and were more in the nature of a private agreement between
9 the Company and a developer which the Commission does not typically approve. Second,
10 assuming that these agreements were actually main extension agreements, the remedy sought by
11 the Council is not the remedy provided by the rule itself. As pointed out by the Company, the
12 rule provides for return of the refund (which the Company has already done) not exclusion of the
13 refund from rate base which is the outcome sought by the Council. For all of these reasons, the
14 Council’s goal of excluding these amounts from rate base under these provisions fails. In
15 addition, equitable considerations would strongly weigh against such action by the Commission.

16 Should the Commission not accept the Council’s legal arguments set forth above, the
17 Council also advances an alternative proposal to phase-in the refunds to the Company’s rate base
18 over time.¹⁵ The Staff does not support this proposal because the record is not clear what
19 impacts this would have on the Company and what accounting treatment this proposal would
20 necessitate. There is actually conflicting evidence on this point by the Company and the
21 Council. The Company believes that the Council’s phase-in proposal would be subject to
22 accounting guidelines SFAS 92 pertaining to Phase-In Plans and SFAS 90 pertaining to Plant
23 Disallowances.¹⁶ The Company states that “[i]n accordance with these accounting guidelines,
24 the phase-in plan proposed by Anthem would require a substantial write off of this plant,
25 resulting in severe financial consequences for the Company.”¹⁷ While Council witnesses
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27 ¹⁴ Company’s Closing Br. at 24.

¹⁵ Council’s Closing Br. at 17.

28 ¹⁶ Tr. Phase I at 310-11 and Company’s Closing Br. at 18.

¹⁷ Company’s Closing Br. at 18.

1 disagree that this drastic accounting treatment would be required¹⁸ in the end it is ultimately the
2 Company and its auditors that must make this determination.¹⁹ Therefore, the Council's opinion
3 may be of little import on this issue.

4 Notwithstanding, the Commission's last rate case order involving the Anthem Water
5 District and the Anthem/Agua Fria Wastewater District (and even in at least one prior
6 Commission Order) stated that the Commission's not having yet addressed the issue, would not
7 have any "bearing on our determination in any subsequent case filed by the Company for these
8 districts regarding the reasonableness of the Company's agreement to refund to Pulte almost all
9 of the costs required to construct Anthem's water infrastructure."²⁰ It is logical for the
10 Commission to address the issue in this case since the Company is requesting inclusion of the
11 balloon payment in rate base in this case.

12 The Council points out that evidence introduced in the two latest hearings involving
13 Anthem suggest that: 1) the Company was aware that the accelerated build-out of the Anthem
14 community ten years ahead of schedule could require the Refund Payments to become due in
15 2007, with payment showing up in the Company's rates years in advance of the dates indicated
16 to the Commission in the 1998 CC&N proceedings²¹; and 2) the Company was aware that
17 Citizens agreement to refund 100% of developer-funded development costs apparently deviated
18 from the usual practice of developers to include approximately 50% of development costs in
19 home prices.²²

20 Staff agrees with RUCO that the infrastructure costs at issue are legitimate costs of
21 service and that the Company should be allowed to recover those costs.²³ Therefore, in
22 examining the reasonableness of the Company's request in this case in light of the evidence in
23 the record cited by the Council, the Staff agrees with RUCO that if the Commission does
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26 ¹⁸ Tr. Phase I at 846: 13-848:22.

27 ¹⁹ Company's Closing Br. at 18-19.

28 ²⁰ Tr. Phase I at 280:15-281:10.

²¹ Council's Closing Br. at 6; *see also* Exhibit S-2.

²² Council's Closing Br. at 8; *see also* Exhibit S-1.

²³ RUCO Closing Br. at 41.

1 anything, the Commission should focus on how the costs are recovered. It is here where the
2 interests of ratepayers and stockholders can be most appropriately balanced.

3 RUCO's Initial Brief suggests an alternative approach for recovery which it apparently
4 believes more appropriately balances the interests of ratepayers and stockholders. RUCO states
5 that its proposal is patterned on the standard ratemaking treatment for advances-in-aid-of-
6 construction ("AIAC"). Under RUCO's recommended alternative ratemaking treatment, nine-
7 tenths of the total amount of water and wastewater refunds made to Pulte during 2008 and 2010
8 would be treated as deductions from the Anthem District's water and wastewater rate bases.²⁴
9 The Company would earn a return on one-tenth of the refund until it files a future rate case
10 application.²⁵ At that time the amount of the original deduction to rate base would be reduced at
11 a rate of one-tenth per year for each of the years between the time that rates go into effect in this
12 proceeding, and the end of the test year in the Company's next rate case filing.²⁶

13 RUCO also states that over the period of time between rate cases, the Company would
14 continue to recover the cost of the plant associated with the refunds through annual depreciation
15 expense, the same as a standard AIAC arrangement. It would only earn a return, however, on the
16 amount of the refund included in rate base.²⁷

17 RUCO also states that in the next case, the Company would not only be permitted to earn
18 a return on a larger rate base, but would also be permitted to recover lost operating income in
19 order to make the Company whole.²⁸ Under RUCO's proposal, the amount of forgone operating
20 income would be amortized over a three-year period and would be recovered on a dollar-for-
21 dollar basis as an operating expense.²⁹

22 Conceptually, Staff does not have a problem with most aspects of the RUCO proposal.
23 However, should the Commission decide to adopt this proposal, Staff would recommend several
24 changes. First, the rate changes should be automatic through the establishment of a set increase
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26 ²⁴ RUCO Closing Br. at 42.

27 ²⁵ *Id.*

27 ²⁶ *Id.*

27 ²⁷ *Id.*

28 ²⁸ *Id.*

28 ²⁹ RUCO Closing Br. at 43.

1 that would occur on a specific date each year. In other words, the Company should not have to
2 wait until its next rate case to obtain recovery of revenue associated with a phase-in of past
3 refunds. If the Company is required to wait as RUCO proposes until it files its next case, the
4 amount of the payment to be included in rates could be significant and could itself be comparable
5 to a balloon payment.

6 Second, RUCO proposes to accumulate and amortize the lost revenue over a period of
7 three years as a separate charge. Instead of this approach, Staff recommends simply including
8 this amount in the preset rate increase for each year. Staff would note that under RUCO's
9 proposal the Company would not be made whole since RUCO's proposal appears to require the
10 Company to forego its return on this plant until it is placed into rate base. Staff would point out
11 that this is not consistent with standard ratemaking treatment for AIAC.

12 Third, the Commission should consider whether a time period shorter than 10 years may
13 be appropriate to minimize the cost to ratepayers. For instance, the Commission could use 5
14 years instead of 10 which should result in lower carrying costs ultimately borne by rate payers, in
15 the event that carrying costs are included by the Commission.³⁰

16 Fourth, RUCO states that "the payment of these refunds has reached its end with this
17 case."³¹ However, that is not correct. In 2010, there was a final refund payment that was made
18 by the Company of \$6.7 million which the Company may seek recovery of in its next rate case.
19 RUCO's Initial Brief does not address how this remaining \$6.7 million should be handled.

20 Finally, if the Commission in concept agrees with RUCO's proposal, Staff would also
21 recommend that the Commission order the Company, Staff, RUCO and any other interested
22 party to work out the specifics with respect to how the proposal would actually be implemented,
23 and the surcharge calculated. If the Commission decides to go along with this type of approach,
24 Staff recommends that the Commission leave this docket open for the parties to work out the
25 exact details of the mechanism and bring it back to the Commission for approval.

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28 ³⁰ Staff also has some concerns regarding Attachment RCS-7 which purportedly contains calculations under this
alternative.

³¹ RUCO Closing Br. at p. 2.

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B. Phase II Rate Design Issues.

1. Anthem/Agua Fria Wastewater District rate design.

Arizona-American argues that the Commission should reject Staff's suggested rate design for the Anthem/Agua Fria Wastewater District.³² The Company states that the Staff's rate design should be rejected because it would unduly increase the dependence of wastewater revenues on water sales which vary significantly from year to year and are declining in Anthem.³³

Staff is not aware of any evidence in the record that water sales are declining in the Anthem community or that water sales vary significantly from year to year. The Staff continues to believe that the months of January, February and March would be a more accurate representation of water usage that is actually treated as wastewater.

Both the Company and the Council point to the requirement in the Anthem community which requires overseeding of winter lawns to rebut the Staff's position that the months of January, February and March would be a more accurate representation of water usage.³⁴ But again there is no evidence in the record as to how many customers this overseeding requirement would impact and to what degree. It can be safely assumed that a portion of the Anthem homeowners probably have desert landscaping and would not be affected by this requirement. Other landowners may have limited grassy areas and thus the impact upon them would likely be diminimis.

The Council also argues that a pure commodity rate as Staff has proposed would be inappropriate.³⁵ It states that it deviates from basic cost of service principles, and that it would increase the Company's dependence on wastewater revenues based on water sales which vary significantly.³⁶ Like the Company, the Council has offered no back up studies to support its

³² Company's Closing Br. at 42.

³³ *Id.*

³⁴ Company's Closing Br. at 44.

³⁵ Council's Closing Br. at 19.

³⁶ Council's Closing Br. at 19.

1 assertion that water sales in Anthem vary significantly or more significantly than is typical or
2 experienced by other water companies.

3 In addition, while the Anthem/Agua Fria Wastewater District is the only wastewater
4 district of the Company which has volumetric wastewater rates, the current volumetric rate
5 design does not encourage conservation. It consists of a fixed monthly charge along with a
6 commodity rate based on water usage with a 7,000 gallon per month ceiling. But as Staff
7 witness Michlik pointed out at the hearing, a customer that uses 7,000 gallons is charged the
8 same amount as a customer that uses 29,000 gallons.³⁷ The Council actually recommended
9 elimination of the commodity charge and reversion back to a fixed charge for all wastewater
10 which would be a significant step backwards in Staff's opinion on the issue of efficient use of
11 water.³⁸

12 **2. Private fire rates.**

13 The Company also argues that Staff's proposed change to the Private Fire Rates of its
14 Water Districts to the greater of \$10 or two percent of the monthly minimum charge for the
15 applicable meter size should be rejected.³⁹ The Company offers no arguments in support of its
16 position other than that it believes that the revision is unwarranted and that it will lead to a
17 dramatic shift of revenues to other classes of customers.⁴⁰ Staff's proposal is consistent with
18 Staff's position in other cases.⁴¹ In addition, the Commission has accepted Staff's position in a
19 number of cases.⁴² The Commission should adopt Staff's recommendation with respect to
20 Private Fire Rates.

21 **3. Staff's five tier rate design.**

22 As the Company notes, at the conclusion of the hearing, the ALJ requested that Staff
23 provide an alternative five-tier rate design with its final schedules.⁴³ If a consolidated rate
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25 ³⁷ Tr. Phase II at 1260:22-1261:14.

26 ³⁸ Niedlinger Rate Design Direct (Ex. Anthem-18) at 4.

27 ³⁹ Company's Closing Br. at 44.

28 ⁴⁰ *Id.*

⁴¹ Tr. Phase II at 1259:5-17.

⁴² *Id.* at 1259:18-1260:11.

⁴³ *Id.*

1 design is utilized, the Company opposes Staff's recommendation and states that the
2 Commission should use the same tiers utilized in the Company's consolidated rate design
3 proposal.⁴⁴ The Company argues that Staff's tiers commence with an initial break point that is
4 too low (i.e., 1,000 gallons in Sun City and 2,000 gallons in Anthem).⁴⁵ The Company also
5 argues that the tiers are not appropriate for the Company's entire system.⁴⁶

6 Staff's initial break points would actually provide a "lifeline" level of rates suitable for
7 low-income water users which some parties support in this case.⁴⁷ Staff does not understand the
8 Company's position that such tiers would not be appropriate for the Company's entire system
9 since the Company offered no further elaboration on this point. Moreover, Staff was asked to
10 structure a five tier rate structure not for the entire Arizona American Water system, but for the
11 Districts involved in this rate case, namely Sun City Water and Anthem Water.

12 4. Staff's tier breakpoints and proposed tier rates.

13 The Council takes issue with Staff's proposed tier breakpoints and rates arguing that
14 they are without "adequate foundation or support and would adversely affect Anthem
15 customers".⁴⁸ The Council is opposed to the increase Staff has proposed in the rates for higher
16 usage water customers and the tier break-points for larger meter sizes.⁴⁹ One of the
17 Commission's primary objectives in setting water rates is efficient use of this precious
18 commodity. Staff's proposed revisions are intended to accomplish this important Commission
19 objective. The Council faults Staff for not having performed a cost of service study to support
20 its proposal and for not discussing any non-cost factors that it considered in arriving at its rate
21 proposals.⁵⁰

22 No party prepared a cost of service study in this case, including the Council. It was not
23 the responsibility of Staff, anymore than it was the responsibility of the Council, to perform a
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25 ⁴⁴ *Id.*

26 ⁴⁵ Company's Closing Br. at 45.

27 ⁴⁶ *Id.*

28 ⁴⁷ Macgruder Br. At 29.

⁴⁸ Council's Closing Br. at 18.

⁴⁹ *Id.*

⁵⁰ *Id.*

1 cost of service study. Nonetheless, this should not act to prevent Staff from considering
2 important objectives of the Commission and proposing rates in line with those objectives.
3 Many parties acknowledged during the course of this proceeding, that rates are not designed on
4 cost of service principles alone. Rather, non-cost factors are oftentimes used by the
5 Commission to set rates as well.

6 **5. Consolidation.**

7 The Company continues to argue that Staff does not support consolidation.⁵¹ This is
8 perhaps too strong of a statement without some elaboration. Staff's position in this case is that
9 the Commission should adopt Staff's stand-alone rate design. Nonetheless, Staff did put forward
10 three alternative consolidated rate design proposals should the Commission decide that
11 consolidation was appropriate in this case.⁵² The Council argues that the partial consolidation
12 alternatives presented by Staff seem arbitrary and unworkable and are myopic.⁵³ Staff's testimony
13 set forth the reasoning behind each of the partial consolidation scenarios, and they were not
14 arbitrary as the Council represents.

15 Staff has always been concerned by the fact that the Company did not propose a
16 consolidated rate design in its direct case. The Company, as the applicant in this case, has the
17 burden of proof. Because it did not submit a direct case for consolidation much of the
18 information one would need to do a cost/benefit analysis was not in the record. The Company
19 was asked to augment the record with this information later in the proceeding, and apparently the
20 Company did provide some information. The Staff also had concerns that the Company did not
21 comply with the Commission's directive that it was to hold Town Hall meetings in each of its
22 Districts on the issue of rate consolidation.⁵⁴ Again, the Company took action late in the
23 proceeding to address this concern by holding additional Town Hall meetings through out its
24 service territory in Districts where meetings of this nature had not before been held.

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27 ⁵¹ Company's Closing Br. at 45.

28 ⁵² Michlik Direct (S-15) at 21-23.

⁵³ Council's Closing Br. at 17.

⁵⁴ Tr. Phase II at 437-438.

1 There have also been issues raised about the use of different test years and how the
2 Commission's directive in the last case that the consolidated rates be "revenue neutral" should be
3 interpreted.⁵⁵ If the Commission desires to adopt a consolidated rate design proposal, Staff
4 believes that these concerns, to the extent they are valid, could be addressed.

5 The Company's proposal includes implementation in five steps over five years, and
6 would consolidate all of its water and wastewater districts.⁵⁶ The Company believes that now is
7 the time for consolidation and that if it is not done now, it probably will not happen for some
8 time. Staff recognizes that consolidation poses some benefits in this case especially with respect
9 to the Anthem Water District and the Anthem/Agua Fria Wastewater District, which otherwise
10 will experience a significant rate increase in this case. Consolidation would spread the higher
11 costs of these districts over all districts to ameliorate the rate impacts associated with full
12 recognition of the Pulte refunds in these districts. Certainly this is one significant factor in favor
13 of consolidation. But, if this is the only reason that consolidation is being proposed by the
14 Company and urged by several others, it is probably not appropriate and the Commission should
15 adopt Staff's proposed stand-alone rates.

16 **6. Deconsolidation of the Anthem/Agua Fria Wastewater District.**

17 The Council urges the Commission, if it adopts a stand-alone rate design, to
18 deconsolidate the Anthem and Agua Fria Wastewater Districts and set separate stand-alone rates
19 for each district.⁵⁷ The Council apparently takes this position because they believe that Agua
20 Fria customers should bear all of the costs of the Northwest Treatment Plant since they state
21 Anthem wastewater customers receive no service from this plant.⁵⁸ There is nothing in the
22 record to support deconsolidation of these two districts at this time. The record is simply devoid
23 of any discussion of whether this would be a good result or not. If the Commission wants this
24 issue to be examined, it should identify it as an issue for the parties to address in the Company's
25 next rate case.

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27 ⁵⁵ RUCO Closing Br. at 58.

⁵⁶ Company's Closing Br. at 45-46.

28 ⁵⁷ Council Closing Br. at 19.

⁵⁸ *Id.* at 20.

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7. Effluent rate.

Corte Bella, DMB White Tanks, and the Anthem Golf and Country Club all urge the Commission to adopt an effluent water rate for the Anthem/Agua Fria Wastewater District.⁵⁹ Corte Bella states that prior to December, 2009, turf irrigators paid \$0.62 per thousand gallons or \$202.00 per acre foot to Arizona-American for non-potable water under the Agua Fria Water District Tariff.⁶⁰ In Decision No. 71410, the Commission approved a rate of \$2.7280 per thousand gallons or \$889.00 per acre foot. Corte Bella filed an application under A.R.S. § 40-252 recently and the Commission reduced the Agua Fria Water District non-potable water rate to \$1.24 per thousand gallons for non-potable water purchased in the Agua Fria District from Arizona-American.⁶¹

Corte Bella proposes an effluent rate of \$250.00 per acre foot. DMB White Tanks has also proposed a rate of \$250.00 per acre foot. While Staff has not taken a position on the appropriate rate for effluent in the Anthem/Agua Fria Wastewater District, Staff does agree that it should be set at a level that encourages the use of effluent for turf irrigation.

8. The Resorts' request for a special classification.

The Resorts have asked for a special classification or to be excluded from any statewide rate design consolidation proposal altogether.⁶² Staff does not believe that the Resorts have met their burden of proof with respect to exclusion from any consolidation proposal the Commission may adopt. Moreover, with respect to the specifics of the Resorts' proposal, Staff does not believe that the Resorts have demonstrated that their specific proposal serves the public interest. While at some point consideration of a special classification may be appropriate, the specifics associated with any special resort classification would need further review.

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⁵⁹ Corte Bella's Closing Brief at 2.
⁶⁰ Id. at 3.
⁶¹ See Docket No. W-01303A-0227 *et al*, June 17, 2010 Procedural Order.
⁶² Resorts' Closing Br. at p. 6.

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9. Adoption of the same rate for 1-inch and 3/4th and 5/8th inch meters.

According to Company witnesses at the hearing, in an effort to mitigate part of the rate increase, some Anthem Water District ratepayers apparently want to switch out to a smaller meter size since the price for a smaller meter is lower under the Company's existing rate design. Fire code restrictions may prevent this.⁶³ As an alternative, it is Staff's understanding that parties were then asked to consider adoption of the same rate for these residential meters. Based upon the following data that Staff has recently reviewed, Staff would not recommend this change.

<u>Meter Size</u>	<u>Average No. Of Customers</u>	<u>Average Consumption</u>	<u>Test Year Revenues</u>
Res. 5/8 and 3/4 inch	4,869	9,616	\$ 2,042,985
Res. 1 inch	3,384	11,203	\$ 2,310,761

As can be seen from the above chart, the average consumption of Anthem residents with larger meter sizes is greater. Thus, adoption of the same rate regardless of meter size may not be appropriate.

If the Commission decides that this change is appropriate, then Staff would recommend against just reducing the 1 inch meter rate down to the 5/8 and 3/4 inch rate. Instead, Staff would recommend that the rate for the 5/8 and 3/4 inch meters be increased as well. Finally, if the Commission decides to adopt a uniform rate for these residential meters, then some adjustment should also be made to the tier breakpoints.

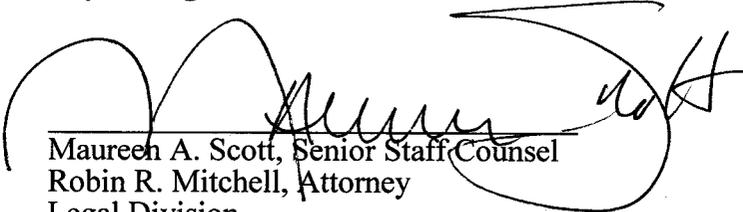
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⁶³ Tr. Phase I at 434-436.

1 **III. CONCLUSION.**

2 The Commission should adopt Staff's positions on the issues in this case for the reasons
3 stated in Staff's filed testimony, and Initial and Reply Briefs filed in this matter.

4 RESPECTFULLY SUBMITTED this 6th day of August 2010.

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