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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

GARY PIERCE, Chairman
SANDRA D. KENNEDY
PAUL NEWMAN
BOB STUMP
BRENDA BURNS

Docket No. W-01303A-10-0448

IN THE MATTER OF THE APPLICATION
OF ARIZONA-AMERICAN WATER
ARIZONA-AMERICAN, 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, AND
MOHAVE WATER DISTRICT

**Notice of Filing Verrado
Community Association, Inc.'s
Surrebuttal Testimony**

Verrado Community Association, Inc., through its undersigned counsel, hereby provides
notice of filing the Surrebuttal Testimony of Kent Simer in the above-referenced matter.

DATED this 2nd of August, 2011.

RYLEY CARLOCK & APPLEWHITE

Arizona Corporation Commission

DOCKETED

AUG 2 2011

DOCKETED BY

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1
2 ORIGINAL and 13 copies of the foregoing filed
3 this 2nd day of August, 2011, with:

4 Docket Control
5 Arizona Corporation Commission
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7 Phoenix, Arizona 85007

8 COPY of the foregoing mailed this
9 2nd day of August, 2011, to:

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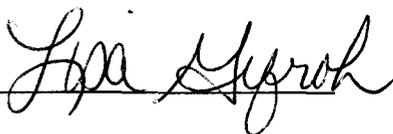
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1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

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15 THEREON FOR UTILITY SERVICE BY
16 ITS AGUA FRIA WATER DISTRICT,
17 HAVASU WATER DISTRICT, AND
18 MOHAVE WATER DISTRICT

14 **Surrebuttal Testimony**

15 **of**

16 **Kent Simer**

17 **on behalf of Verrado Community Association, Inc.**

18 **August 2, 2011**

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1 **Q1. PLEASE STATE YOUR NAME, ADDRESS AND OCCUPATION.**

2 A1. My name is Kent R. Simer. My business address is 160 N. Pasadena, Suite 101, Mesa, Arizona.
3 I am a Utility Rate Consultant for K. R. Saline & Associates, PLC, a firm that provides electrical
4 engineering services, management consulting, and ongoing business operational services
5 primarily to wholesale public electric utilities.

6 **Q2. DID YOU PREVIOUSLY FILE DIRECT TESTIMONY IN THIS PROCEEDING?**

7 A2. Yes, I did.

8 **Q3. ON WHOSE BEHALF ARE YOU APPEARING IN THIS PROCEEDING?**

9 A3. I am appearing on behalf of the Verrado Community Association, Inc. ("Verrado"). Verrado is a
10 customer of Arizona-American's Water Company ("Arizona-American"), and has as members
11 numerous residential and commercial customers who are directly impacted by the rates proposed
12 by Arizona-American.

13 **Q4. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS CASE?**

14 A4. In this Surrebuttal, I am responding to Arizona-American and other witnesses' testimony as I
15 identify in more detail in below.

16 **Q5. HAVE YOU REVIEWED THE REBUTTAL TESTIMONY OF MR. TOWNSLEY IN
17 REGARD TO THE WHITE TANKS REGIONAL WATER TREATMENT FACILITY?**

18 A5. Yes. I have reviewed Mr. Townsley's rebuttal testimony that addresses Arizona-American's
19 investment in the White Tanks Regional Water Treatment Facility ("White Tanks Plant").

20 **Q6. PLEASE SUMMARIZE MR. TOWNSLEY'S POSITION REGARDING THE NEED FOR
21 CONSTRUCTING THE WHITE TANKS PLANT.**

22 A6. In his rebuttal testimony, Mr. Townsley states that "the primary need for the White Tanks Plant
23 was identified early in the decade – to allow Arizona-American to utilize its full allowance of
24 CAP water and reduce groundwater consumption." (Townsley, 12) The need for the
25 construction of a regional water treatment plant that Townsley mentions was first identified by a
26 consortium of West Valley water providers ("WESTCAPS") that urged water users to maximize
27 their use of renewable Central Arizona Project ("CAP") water to limit the West Valley's
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1 overreliance on groundwater. Mr. Townsley also states that the construction of the plant was
2 entirely consistent with recommendations made by the Blue Ribbon Panel on Water
3 Sustainability, a panel of water experts formed by Arizona Governor Jan Brewer that promotes
4 the acquisition of renewable surface water resources (CAP) in advance of supply needs.

5 **Q7. WHAT IS YOUR RESPONSE TO MR. TOWNSLEY'S TESTIMONY**

6 A7. Mr. Townsley's rebuttal testimony regarding the primary reason for Arizona-American's
7 construction of the White Tanks Plant contradicts previous statements made by Arizona-
8 American that point to customer growth as driving the need for the White Tanks Plant. In
9 Arizona- American's original Application for approval of the Maricopa County Municipal Water
10 Conservation District Number One ("MWD")-constructed plant, Arizona-American proposed to
11 lease 7.5 MGD of the initial 13.5 MGD of the capacity of the plant.¹ Arizona-American
12 determined that construction of a stand-alone plant would be more expensive than leasing from
13 MWD's plant due to economies of scale.² Arizona-American had sought to work jointly with
14 MWD to share the burden of owning and operating a regional treatment plant, as well as more
15 readily providing access to MWD water allocations on the Agua Fria River that could be made
16 available to Arizona-American to reduce its groundwater use. After negotiations with MWD
17 collapsed, Arizona-American proposed to use water hook-up fees to finance the construction of
18 the plant. Arizona-American stated in its initial brief filed in docket W-01303A-05-0718 that:

19 *If Arizona-American were experiencing little or no growth in the Agua Fria*
20 *Water District, it is unlikely that it would participate in a new surface-water*
21 *treatment plant, either by building it or by buying treatment from a third party.*³
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26 ¹ Application, Docket No. W-01303A-05-0718, October 11, 2005, p. 8.

27 ² Application, Docket No. W-01303A-05-0718, October 11, 2005, p. 10.

28 ³ Initial Brief of Arizona-American, April 17, 2007, Docket No. W-01303A-05-0718, p.15

1 After the WESTCAPS study in 2001, Arizona-American was not able to immediately start on the
2 construction of the plant; however, “accelerating growth” forced their hand⁴ to find a financing
3 alternative for the plant. In my Direct Testimony in this case I discussed Arizona-American’s
4 use of hook-up fees to finance the plant and Arizona-American’s position that the use of hook-up
5 fees “is equitable because customer growth is largely driving the need for the plant.” The use of
6 hook-up fees as a mechanism to burden future customers with the costs associated with plant
7 needed to handle growth was also explained by ACC Staff witness Dorothy Hains. In a discovery
8 response in this case, Dorothy Hains stated:

9 *Generally speaking, the purpose of a hookup fee tariff is to create a plan to*
10 *request future customers to pay for additional plant items such as source, storage,*
11 *pump station and transmission lines due to growth.*⁵

12 However, growth didn’t last. By 2006 the population boom experienced in the Phoenix area was
13 slowing and Arizona-American instead was able to add other low cost resources and facilities to
14 support its groundwater system, enabling it to “push back the completion of the White Tanks
15 Plant to the end of 2009.” (Townesley, 6). Again, this contradicts the notion that the need for the
16 plant was predicated on the development of Arizona-American’s CAP allocation. Installing other
17 low cost facilities and delaying the plant, illustrates that reducing groundwater production was
18 not an immediate goal for Arizona-American. Arizona-American understood by late 2007 that
19 collections of hook-up fees were already slower than expected, but it still intended to pay for the
20 plant with hook-up fees, inferring that future customers should pay for the plant.⁶

21 As I have demonstrated, the construction of the White Tanks Plant was built on the
22 premise that Arizona-American was developing its CAP allocation to serve future customers
23 and intended to finance the plant with hook-up fees paid by new customers. Mr. Townesley is
24

25
26 ⁴ Rebuttal Testimony of Paul G. Townesley, Page 22.

27 ⁵ Dorothy Hains’ Response to RUCO Data Request Q.1.07, July 11, 2011

28 ⁶ Exceptions of Arizona-American, September 13, 2007, Docket No. W-01303A-05-0718, p. 1.

1 trying to redirect the purpose of the plant to state that it was constructed to benefit all customers
2 because it would result in less groundwater pumping. Existing customers do not benefit from
3 this plant as they were already adequately served by an existing well system. Existing customers
4 are actually harmed in that they were originally promised that rates would not be impacted by the
5 construction of the plant because it was to be paid for through water hook-up fees.

6 **Q8. WAS ARIZONA-AMERICAN WRONG FOR CONSTRUCTING THE PLANT?**

7 A8. Probably not as to future customers. Population forecasts projected significant growth for the
8 Phoenix metropolitan area. Facing the need to serve the future customers, Arizona-American
9 had a responsibility to plan for the growth. Arizona-American faces increasing difficulties with
10 development of suitable new well sites due to treatment costs and well spacing requirements, so
11 developing Arizona-American's CAP allocation is a logical conclusion and is in line with current
12 water policy in Arizona. However, as was known during the design phase, the system's current
13 surface water and groundwater production and treatment capabilities are duplicative and exceed
14 the needs of the existing customer base.

15 **Q9. WHAT ARE THE REPERCUSSIONS OF THE PLANT?**

16 A9. With population growth falling far short of Arizona-American's earlier forecasts, Arizona-
17 American customers now find themselves with an adequate groundwater system that includes
18 sufficient peaking and redundancy capacity as well as a water treatment plant for surface water
19 that is built to peak CAP contract amounts with plant redundancy. The groundwater system and
20 the surface water treatment, when viewed separately, could both be considered used and useful.
21 Collectively, however, there is a significant over investment in facilities to serve the existing
22 customer base and at any given time a significant portion of the total plant is not used or needed.

23 Additionally, there are newer Agua-Fria customers who paid for a portion of the plant
24 through hook-up fees, and are now faced with possibly paying for the plant through increased
25 rates too. The construction of the White Tanks Plant was built on the premise that rates would
26 not be impacted by the construction because it would be paid through hook-up fees and deferred
27 AFUDC. That plan should not change.
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1 **Q10. WHAT DO YOU PROPOSE?**

2 A10. Arizona-American's proposal to include the White Tanks Plant in the rate base is the leading
3 cause behind the 78.7% increase in water revenues. The growth simply did not materialize to
4 support this plant, and existing customers are being asked to bear the burden of the cost of a
5 system that far exceeds their needs. Arizona-American should bear some of the risk associated
6 with this plant, rather than placing it all on their customers.

7 The plant should continue to be funded primarily through application of hook-up fees as
8 they become available. If the Commission disagrees with me, however, and instead decides to
9 place any additional portion of the plant into existing customers' rates, then the Commission
10 should allow no more than half of the plant costs to be included in rate base "as proposed by
11 RUCO, and the rates should be phased in over a period of years in order to reduce rate shock to
12 existing customers.

13 **Q11. WHAT ARE YOUR COMMENTS WITH RESPECT TO THE REBUTTAL**
14 **TESTIMONY OF MR. TOWNSLEY REGARDING THE INFRASTRUCTURE**
15 **REPLACEMENT SURCHARGE?**

16 A11. The infrastructure system replacement surcharge ("ISRS") is a proposed surcharge that would be
17 designed to collect additional revenues, restricted by an annual cap, to be used for the purpose of
18 performing much needed replacements in the Havasu and Mohave water districts. Mr. Townsley
19 readily accepts Mr. Rigsby's claim that these would be "routine plant improvements that would
20 normally be recovered in a general rate case proceeding." Mr. Townsley states the ISRS would
21 smooth out future rate increases and would help address the Unaccounted for Water issues in the
22 districts.

23 I support the position taken by RUCO in Mr. Rigsby's direct testimony docketed June 27,
24 2011. The implementation of an ISRS is simply an attempt to create a new stream of revenues
25 for Arizona-American. RUCO and Arizona-American agree that these are routine plant
26 improvements. There is nothing extraordinary about the planned investments, so there is no need
27 for the Commission to adopt a special surcharge for such additions.
28

1 Investments made as a product of the surcharge would be placed into the rate base prior
2 to a prudency review in the next rate case proceeding. RUCO points out the problem with this in
3 their testimony:

4 Under the Company-proposed ISRS, AAWC would enjoy the benefit of receiving a
5 return on and a return of its investment in new plant through a surcharge established
6 between general rate case proceedings in addition to a return on and a return of the
7 plant that it is replacing. Unfortunately ratepayers receive no benefit from any cost
8 savings that are related to the plant additions that they will be paying for through the
9 ISRS...⁷

10 The Commission should not accept the proposed ISRS because (1) there is nothing extraordinary
11 that would warrant the extraordinary ratemaking device and (2) the surcharge would allow
12 Arizona-American to temporarily circumvent the Commission's responsibility to review plant
13 placed into rate base, allowing Arizona-American to earn a greater return than what might be
14 allowed. Rejecting the proposed ISRS would also conform to the Commission's past decision
15 for the Sun City Water District made in Decision No. 72047 (see pp. 90-92).

16 **Q12. ARE THERE ADDITIONAL REASONS WHY THE COMMISSION SHOULD REJECT**
17 **THE INFRASTRUCTURE REPLACEMENT SURCHARGE?**

18 A12. Yes. Arizona-American has been requested in Decision No. 72047 to present the Commission
19 with a proposal for complete consolidation of their Arizona water utilities, including the Agua
20 Fria Water District. Arizona-American has stated in this case that the proposed ISRS would be
21 adopted by Arizona-American's other water districts if Arizona-American were to proceed with
22 consolidation. Since the ISRS has the potential to impact customers outside of the Havasu and
23 Mohave districts, it would be premature for the Commission to allow the use of an ISRS prior to
24 a Commission decision regarding consolidation.

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27 ⁷ RUCO Direct Testimony, June 27, 2011, pp. 5-6.

1 **Q13. WHAT ARE YOUR COMMENTS WITH RESPECT TO THE REBUTTAL**
2 **TESTIMONY OF MILES H. KIGER IN REGARD TO THE DECLINING USAGE**
3 **ADJUSTMENT?**

4 A13. The declining usage adjustment is a proposed downward adjustment to the test year revenues to
5 reflect the continued downward change in the average usage per customer. The normalization of
6 the test year revenues is intended to ensure Arizona-American's ability to earn its authorized rate
7 of return. Mr. Kiger continues to support the theory that declining usage is driven primarily by
8 conservation efforts made by the customers:

9 *According to Mr. Arndt, "there has been no showing that these conservation efforts*
10 *[declining usage] can be sustained in the future. It is likely that any conservation*
11 *efforts by residential customers have been maximized and there are no future*
12 *conservation possibilities available in the future to sustain usage declines*
13 *experienced in the past. The reality of declining residential usage per customer over*
14 *the past 12 months flatly contradicts Mr. Arndt's assertion that there are no future*
15 *conservation possibilities available, to residential customers. (Surrebuttal*
16 *Testimony of Miles H. Kiger, p. 4)."*

17 Neither Mr. Kiger nor any other Arizona-American staff refuted the claims I made in my Direct
18 Testimony in which I associate declining usage to foreclosures and bank owned homes, not
19 necessarily conservation efforts. As Mr. Kiger points out, typical residential water usage
20 consists of use for cooking, drinking, washing, cleaning, hygiene, and outdoor water needs. A
21 foreclosed or bank-owned home may drop into a maintenance mode, where water is only used
22 for outdoor water needs to maintain the appearance of the home to assist with the sale of the
23 property. This would without a doubt contribute to a decline in residential usage per customer
24 because of a significant change in usage characteristics. One would expect usage to again
25 increase as homes are reoccupied. There is no way to know without further study whether
26 declining use will continue when economic conditions improve.

1 **Q14. MR. KIGER CLAIMS THAT SIMPLE OPPOSITION TO THE DECLINING USAGE**
2 **PER CUSTOMER DOES NOT REFUTE THE EXISTENCE OF DECLINING USAGE**
3 **PER CUSTOMER, AND IT SHOULD BE FACTORED INTO THIS RATE REQUEST.**
4 **DO YOU AGREE WITH MR. KIGER?**

5 A14. No. I still support my position made in my Direct Testimony that the Declining Usage
6 Adjustment is not of sufficient magnitude to warrant extraordinary rate treatment. Similar to
7 Staff's response reflected in Decision No. 71845 (pp. 69-71) regarding Arizona Water
8 Company's request for a purchased water adjuster mechanism, the Commission should reject
9 Arizona-American's declining residential usage adjuster because (1) the decline in residential
10 use has not had significant impact on Arizona-American; (2) the adjuster mechanism would not
11 incentivize Arizona-American to seek cost reducing alternatives; and (3) the adjustment
12 mechanism is burdensome and not administratively efficient, and the related cost of
13 administration could exceed potential benefits.

14 Adjusting revenues due to a change in usage characteristics caused by foreclosure activity
15 is akin to adjusting revenues because seasonal use customers don't use the same quantity of
16 water as year-round customers. As I stated in my testimony, in my opinion, this adjustment is an
17 attempt by Arizona-American to shield Arizona-American from negative effects in the economy.
18 Allowing the revenue adjustment would leave no incentive for Arizona-American to seek its own
19 cost reducing alternatives, and would set precedent for future rate cases.

20 **Q15. AFTER REVIEWING THE REBUTTAL TESTIMONY OF MR. BRODERICK, WHAT**
21 **IS AN APPROPRIATE CAPITAL STRUCTURE FOR ARIZONA-AMERICAN?**

22 A15. Mr. Broderick continues to support Arizona-American's position to exclude short term debt from
23 the capital structure. Arizona-American incurred a significant amount of short term debt during
24 the construction of the White Tanks Plant and is seeking long term debt financing in Docket WS-
25 01303A-10-0470. The Commission has consistently denied Arizona-American's request to
26 exclude short term debt from their capital structure taking the position that short term debt is a
27 source of funds available to the Arizona-American and that excluding it would in effect
28

1 compensate shareholders for a non-existent equity investment. Mr. Broderick acknowledges that
2 Arizona-American is losing the argument regarding the exclusion of short term debt from its
3 capital structure. Arizona-American, as Mr. Arndt pointed out, also conceded the argument in
4 Docket No. W-O1303A-09-0343.

5 Inclusion of short term debt is consistent with past commission decisions. Mr. Broderick,
6 however, provided an updated balance of short term debt as of June 30, 2011 in Rebuttal Exhibit
7 TMB-1 reflecting a balance that was over \$3 million lower than originally filed. Recognizing
8 Arizona-American's efforts to pay down or refinance short term debt, Arizona-American should
9 include short term debt in their capital structure at this time, but should be allowed to file
10 balances of short term debt as the case progresses. If Docket WS-01303A-10-0470 results in
11 long term debt refinancing of the outstanding balance, Arizona-American should also be allowed
12 to update this docket with the new debt balances. I am recommending the Commission adopt the
13 capital structure as currently outlined in Rebuttal Exhibit TMB-1 of 60.55% debt and 39.45%
14 equity.

15 **Q16. DOES MR. GUASTELLA'S REBUTTAL TESTIMONY IN REGARD TO THE**
16 **PROPOSED NEW DEPRECIATION RATES CHANGE YOUR OPINION OFFERED IN**
17 **DIRECT TESTIMONY?**

18 A16. No. As I stated in my direct testimony, the adjustment to depreciation rates proposed by Arizona-
19 American will contribute to the significant rate shock that the customers will experience from the
20 rates proposed in this case. Arizona-American responded to Staff requests that "the course
21 corrections in depreciation rates would likely not be so significant as to render past depreciation
22 accruals as unreasonable," demonstrating that existing rates may be just as suitable. Given the
23 potential impact to rates of Agua Fria customers from the outcome in this case, I recommend the
24 Commission not accept Arizona-American's proposed changes to depreciation rates at this time.
25 In Decision No. 72047 Arizona-American has been requested to present the Commission with a
26 proposal for complete consolidation of their Arizona water utilities. If consolidation is accepted,
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1 establishing new depreciations in a rate case subsequent the consolidation would be appropriate
2 to ensure consistent depreciation rates across all of Arizona-American's water utilities.

3 **Q17. ARE THERE ANY OTHER CONCERNS THAT AFFECT THE REVENUE**
4 **REQUIREMENTS?**

5 A17. Yes. In the testimony of Mr. Kiger, Arizona-American provided updated Fuel and Power
6 Expense which included a projected average bill increase of 6.6% resulting from an APS rate
7 application filed on June 1, 2011 in Docket No. E-01345A-11-0224. The Commission has
8 obviously not yet issued a decision in that case. The APS rate case is likely to proceed well after
9 this case has concluded, so inclusion of the APS rate increase would allow the Arizona-
10 American to earn a return on increased fuel and power expense prior to the expense actually
11 increasing. Additionally, APS is not guaranteed they will receive the 6.6% being requested, and
12 it is not known and measurable at this time. Arizona-American should provide an updated
13 calculation for Fuel and Power expense, excluding adjustments made in anticipation of an APS
14 6.6% rate increase, in their Rejoinder Testimony.

15 **Q18. WHAT COMMENTS DO YOU HAVE IN REGARD TO RATE DESIGN TESTIMONY**
16 **OF IAN C. CROOKS?**

17 A18. Mr. Crooks reiterates Arizona-American's position regarding the proposed irrigation Tariff. The
18 proposed rate design would establish a new rate that clearly defines the terms and conditions of
19 service and applicability for potable irrigation service. Residential and commercial customers
20 that fit these descriptions would then be moved under the new proposed rate. Mr. Crooks rejects
21 Mr. Arndt's Direct Testimony that the establishment of the tariff would create a revenue
22 deficiency for Arizona-American, and correctly points out that the rate creates a cost shift
23 amongst rates. However, Mr. Crooks does not respond to Mr. Arndt's statement regarding
24 Arizona-American's failure to provide a cost-of-service study to support a new irrigation rate. I
25 agree in principle with Mr. Crooks that like customers should be billed under like rates, thus a
26 clearly defined potable irrigation rate would better segregate this class of customers. However, I
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1 must also agree that prior to a review of a cost-of-service study, I cannot support the rate design
2 as proposed by Arizona-American.

3 The purpose behind a cost-of-service study is to clearly categorize revenue requirements
4 by their function and allocate these expenses across customer classes in fair and equitable
5 manner. The results of a study conclude whether each customer class is effectively covering
6 their share of operating expenses and the authorized rate of return under the current rate design
7 scheme. Rates are not necessarily designed to match the results of a cost-of-service study
8 exactly; however, the studies do establish a litmus test to judge the appropriateness of the rate
9 design.

10 Arizona-American's failure to provide a cost-of-service study in this rate case, precludes
11 us from being able to make a determination of the fairness of their proposed rate design. Given
12 the Direct Testimony of Verrado Community Association, Inc. witness Melinda Gulick, the rates
13 as proposed would have significant rate shock implications to residents in the Verrado
14 community. Establishing a new rate class of customers, especially one that has significant
15 consequences to customers, without completing a cost-of-service study would go against basic
16 rate setting principles. The Commission should reject any increase in the irrigation rates as
17 proposed until a cost-of-service study is presented.

18 **Q19. ARE THERE ANY OTHER COMMENTS?**

19 A19. Yes. As I stated in my Direct Testimony, the rate increases requested by Arizona-American,
20 specifically for the Agua Fria Water District customers, by any measure constitute Rate Shock.
21 As adjusted in Rebuttal Schedule A-1, a 71.2% increase is projected for residential customers in
22 the Agua-Fria area. This 71.2% increase is driven by the proposed inclusion of the White Tanks
23 Plant to be paid for by customers who were already adequately served by an existing
24 groundwater system. The Commission should recognize this unique situation by requiring
25 Arizona-American to bear more of the cost risk for the White Tanks Plant than the company
26 proposes. A Rate of Return is allowed for regulated utilities because of the risk they bear for
27 making investments in utility systems. Allowing the complete inclusion of the White Tanks
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1 Plant into rate base at this time is, in my opinion, removing the risk that should be borne by
2 Arizona-American rather than placing the severe consequences of that decision on rate payers.

3 In my Direct Testimony I proposed instituting a phase-in of the proposed rates to mitigate
4 the rate shock that results if the Commission allows the inclusion of the White Tanks Plant costs
5 as proposed. The rejection of the proposed depreciation rates would also assist in mitigating rate
6 shock. Arizona-American could defer instituting new depreciation rates to a point that may be
7 more appropriate, such as subsequent to a complete water utility consolidation.

8 **Q20. DOES THIS CONCLUDE YOUR TESTIMONY?**

9 A20. Yes.

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