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BEFORE THE ARIZONA CORPORATION COMMISSION

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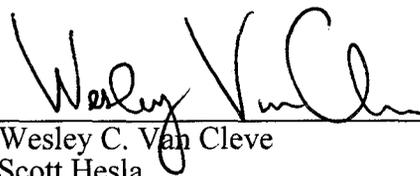
IN THE MATTER OF THE APPLICATION OF ARIZONA WATER COMPANY, AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR ADJUSTMENTS TO ITS RATES AND CHARGES FOR UTILITY SERVICE FURNISHED BY ITS WESTERN GROUP AND FOR CERTAIN RELATED APPROVALS.

DOCKET NO. W-01445A-10-0517

**STAFF'S NOTICE OF FILING OF TESTIMONY IN SUPPORT OF THE PROPOSED SETTLEMENT AGREEMENT**

The Utilities Division ("Staff") of the Arizona Corporation Commission ("Commission") hereby files the testimony of Steven M. Olea in support of the Proposed Settlement Agreement in the above referenced docket.

RESPECTFULLY SUBMITTED this 21<sup>st</sup> day of February, 2012.



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Original and thirteen (13) copies of the foregoing filed this 21<sup>st</sup> day of February, 2012, with:

Docket Control  
 Arizona Corporation Commission  
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 Phoenix, Arizona 85007

Arizona Corporation Commission  
**DOCKETED**

FEB 21 2012

DOCKETED BY 

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BEFORE THE ARIZONA CORPORATION COMMISSION

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

IN THE MATTER OF THE APPLICATION OF ) DOCKET NO. W-01445A-10-0517  
ARIZONA WATER COMPANY, AN ARIZONA )  
CORPORATION, FOR A DETERMINATION OF )  
THE FAIR VALUE OF ITS UTILITY PLANT )  
AND PROPERTY AND FOR ADJUSTMENTS )  
TO ITS RATES AND CHARGES FOR UTILITY )  
SERVICE FURNISHED BY ITS WESTERN )  
GROUP AND FOR CERTAIN RELATED )  
APPROVALS. )  
\_\_\_\_\_ )

TESTIMONY  
IN SUPPORT OF  
THE SETTLEMENT AGREEMENT  
STEVEN M. OLEA  
DIRECTOR  
UTILITIES DIVISION  
ARIZONA CORPORATION COMMISSION

FEBRUARY 21, 2012

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**EXECUTIVE SUMMARY  
ARIZONA WATER COMPANY  
DOCKET NO. W-01445A-10-0517**

Mr. Olea's testimony supports the adoption of the Settlement Agreement ("Agreement") as proposed by the Signatories in this case. This testimony describes the settlement process as open, candid, transparent and inclusive of all parties to this case. Mr. Olea explains why Staff believes this Agreement is in the public interest.

Mr. Olea's testimony recommends that the Commission adopt the Agreement as proposed.

1     **SECTION I - INTRODUCTION**

2     **Q.     Please state your name and business address.**

3     A.     Steven M. Olea, 1200 West Washington, Phoenix, Arizona, 85007.

4  
5     **Q.     By whom and in what capacity are you employed?**

6     A.     I am employed by the Arizona Corporation Commission (“Commission”) as the Director of  
7     the Utilities Division (“Division”).

8  
9     **Q.     Please state your educational background.**

10    A.     I graduated from Arizona State University (“ASU”) in 1976 with a Bachelors Degree in Civil  
11    Engineering. From 1976 to 1978 I obtained 47 graduate hours of credit in Environmental  
12    Engineering at ASU.

13  
14    **Q.     Please state your pertinent work experience.**

15    A.     From April 1978 to October 1978 I worked for the Engineering Services Section of the  
16    Bureau of Air Quality Control in the Arizona Department of Health Services (“ADHS”). My  
17    responsibilities were to inspect air pollution sources to determine compliance with ADHS  
18    rules and regulations.

19  
20    From November 1978 to July 1982 I was with the Technical Review Unit of the Bureau of  
21    Water Quality Control (“BWQC”) in ADHS (this is now part of the Arizona Department of  
22    Environmental Quality [“ADEQ”]). My responsibilities were to review water and  
23    wastewater construction plans for compliance with ADHS rules, regulations, and  
24    Engineering Bulletins.

25

1 From July 1982 to August 1983 I was with the Central Regional Office, BWQC, ADHS. My  
2 responsibilities were to conduct construction inspections of water and wastewater facilities to  
3 determine compliance with plans approved by the Technical Review Unit. I also performed  
4 routine operation and maintenance inspections to determine compliance with ADHS rules  
5 and regulations, and compliance with United States Environmental Protection Agency  
6 requirements.

7  
8 From August 1983 to August 1986 I was a Utilities Consultant/Water-Wastewater Engineer  
9 with the Division. My responsibilities were to provide engineering analyses of Commission  
10 regulated water and wastewater utilities for rate cases, financing cases, and consumer  
11 complaint cases. I also provided testimony at hearings for those cases.

12  
13 From August 1986 to August 1990 I was the Engineering Supervisor for the Division. My  
14 primary responsibility was to oversee the activities of the Engineering Section, which  
15 included one technician and eight Utilities Consultants. The Utilities Consultants included  
16 one Telecommunications Engineer, three Electrical Engineers, and four Water-Wastewater  
17 Engineers. I also assisted the Chief Engineer and performed some of the same tasks as I did  
18 as a Utilities Consultant.

19  
20 In August 1990 I was promoted to the position of Chief Engineer. My duties were somewhat  
21 the same as when I was the Engineering Supervisor, except that now I was less involved with  
22 the day-to-day supervision of the Engineering Staff and more involved with the  
23 administrative and policy aspects of the Engineering Section.

24

1 In April 2000 I was promoted to the position of one of two Assistant Directors of the  
2 Division. In this position I assisted the Division Director in the policy aspects of the  
3 Division. I was primarily responsible for matters dealing with water and energy.

4  
5 In August 2009 I was promoted to my present position as Director of the Utilities Division.  
6 In this position I manage the day-to-day operations of the Utilities Division with the  
7 assistance of the Utilities Division Assistant Director and oversee the management of the  
8 Division's Telecom & Energy Section, the Financial & Regulatory Analysis Section, the  
9 Consumer Services Section, the Engineering Section and the Administrative Section. In  
10 addition, I am responsible for making policy decisions for the Division.

11  
12 In early 2010 I was given the task of being the Interim Director for the Commission's Safety  
13 Division (Railroad and Pipeline). The day-to-day activities of the Safety Division are  
14 overseen by the managers of the Railroad Safety Section and the Pipeline Safety Section with  
15 input from me. Together with the Commission's Executive Director, I am responsible for the  
16 policy decisions for the Safety Division.

17  
18 **Q. What is the purpose of your testimony in this case?**

19 A. The purpose of my testimony is to support the Proposed Settlement Agreement  
20 ("Agreement"). I will also provide testimony which addresses the settlement process,  
21 public interest benefits and general policy considerations.

22  
23 **Q. Did you participate in the negotiations that led to the execution of the Agreement?**

24 A. Yes, I did.

1 **Q. How is your testimony being presented?**

2 A. My testimony is organized into four sections. Section I is this introduction, Section II  
3 provides discussion of the settlement process, Section III discusses the various parts of the  
4 Agreement, and Section IV identifies and discusses the reasons why the Agreement is in  
5 the public interest.

6  
7 **Q. Will there be other Staff witnesses providing testimony in this case?**

8 A. All Utilities Division Staff ("Staff") witnesses that filed Direct Testimony prior to the  
9 Agreement will be available if the Commission has questions for them.

10

11 **SECTION II – SETTLEMENT PROCESS**

12 **Q. Please discuss the settlement process.**

13 A. The settlement process was open, transparent and inclusive. All parties received notice of  
14 the settlement meetings and were accorded an opportunity to raise, discuss, and propose  
15 resolution to any issue that they desired.

16

17 **Q. Over what period did the Settlement meetings take place?**

18 A. Settlement meetings took place on January 31 and February 2 of 2012 at the  
19 Commission's offices. All parties to this Docket were notified of the settlement  
20 discussion process, were encouraged to participate in the negotiations, and were provided  
21 with an equal opportunity to participate.

22

1 **Q. Who participated in those meetings?**

2 A. The following parties (collectively, the "Signatories") were participants in one or both of  
3 the meetings: Arizona Water Company ("AWC" or "Company"); the Residential Utility  
4 Consumer Office ("RUCO"); Abbott Laboratories ("Abbott"); Water Utilities Association  
5 of Arizona ("WUAA"); and Staff.

6  
7 **Q. How many of these parties executed the Agreement?**

8 A. The Agreement was signed by all participants.

9  
10 **Q. Was there an opportunity for all issues to be discussed and considered?**

11 A. Yes, each party had the opportunity to raise and have its issues considered.

12  
13 **Q. Were the Signatories able to resolve all issues?**

14 A. Yes, the Signatories were able to resolve and reach agreement on all issues.

15  
16 **Q. How would you describe the negotiations?**

17 A. I believe that all participants zealously advocated and represented their interests. I would  
18 characterize the discussions as candid but professional.

19  
20 **Q. Would you describe the process as requiring give and take?**

21 A. Yes, I would. As a result of the varied interests represented in the settlement process, a  
22 willingness to compromise was necessary. As evidenced in the Agreement, the  
23 Signatories compromised on the varied litigation positions held by the respective parties.

1 **Q. Because of such compromising, do you believe the public interest was compromised?**

2 A. No. As I will discuss later in this testimony, I believe that the compromises made by the  
3 Signatories further the public interest.

4

5 **Q. What is the revenue increase and cost of equity requested by the Company?**

6 A. AWC requested a total revenue increase of \$4,535,878, which included a requested cost of  
7 equity of 12.1 percent.

8

9 **Q. What is the revenue increase and cost of equity recommended by the settling parties?**

10 A. The settling parties recommend a total revenue increase of \$3,244,403, which includes a  
11 10.0 percent cost of equity.

12

13 **SECTION III – SETTLEMENT AGREEMENT**

14 **Q. Please describe Part I of the Agreement.**

15 A. Part I is a brief description of the procedural history of this docket and a general  
16 description of the settlement process and of the Agreement itself.

17

18 **Q. Please describe Part II of the Agreement.**

19 A. Part II of the Agreement discusses the Signatories' proposed revenue requirement and fair  
20 value rate base for the Pinal Valley, White Tank, and Ajo systems and is accompanied by  
21 supporting schedules. The proposed revenue is \$21,862,556, which is an increase of  
22 \$3,224,403 from current revenues. The proposed Fair Value Rate Base is \$53,234,209,  
23 which is equal to the Original Cost Rate Base.

1 **Q. Please describe Part III of the Agreement.**

2 A. This section of the Agreement addresses the Company's cost of capital. A capital  
3 structure comprised of 49.03 percent long-term debt and 50.97 percent common equity is  
4 proposed.

5  
6 A return on common equity of 10.0 percent and a Weighted Average Cost of Capital of  
7 8.44 percent are proposed.

8  
9 **Q. Please discuss Part IV of the Agreement.**

10 A. Part IV of the Agreement discusses the Signatories' proposed rate design and is  
11 accompanied by supporting schedules. The proposed rate design results in the following:

12 1. For Pinal Valley (Coolidge, including the Coolidge Airport system, and Casa  
13 Grande), the average use (8,500 gallons) residential customer will see an increase  
14 of \$1.81 or 6.17% and the median use (6,107 gallons) residential customer will see  
15 an increase of \$0.88 or 3.49%. These increases are lower than both the Company's  
16 and Staff's direct testimony proposals. The Company's direct testimony would  
17 have resulted in an average increase of \$9.33 or 31.82% and a median increase of  
18 \$8.31 or 32.95%. Staff's direct testimony proposed rates that would have resulted  
19 in an average increase of \$2.06 or 7.03% and a median increase of \$1.37 or 5.43%.  
20 Even though the total revenue being proposed in this Agreement is greater than  
21 Staff's, the Signatories were able to achieve a smaller rate increase for both the  
22 average and median use customers by lowering the proposed monthly minimum  
23 charges and increasing the rate spread for the commodity charges between tiers.  
24 Not only does this lower the average and median use residential bills, but also  
25 promotes more efficient water use.

1           2. For Stanfield, which is currently partially consolidated with Pinal Valley (Stanfield  
2           currently has the same monthly minimums as Pinal Valley, but different  
3           commodity charges), the average use (8,271 gallons) residential customer will see  
4           a decrease of \$8.52 or 21.75% and the median use (6,537 gallons) residential  
5           customer will see a decrease of \$1.01 or 20.31%. These decreases are greater than  
6           both the Company's and Staff's direct testimony proposals. The Company's direct  
7           testimony would have resulted in an average decrease of \$1.01 or 2.58% and a  
8           median increase of \$0.57 or 1.68%. Staff's direct testimony proposed rates that  
9           would have resulted in an average decrease of \$8.25 or 21.06% and a median  
10          decrease of \$6.43 or 18.98%. These larger rate decreases are also possible because  
11          of the decrease in the proposed monthly minimums and the larger rate spread  
12          between tiers.

13          3. For Ajo, the average use (4,764 gallons) residential customer will see a decrease of  
14          \$4.66 or 9.28% and the median use (3,201 gallons) residential customer will see a  
15          decrease of \$4.55 or 11.14%. The Company's direct testimony would have  
16          resulted in an average increase of \$2.94 or 5.85% and a median increase of \$3.35  
17          or 8.2%. Staff's direct testimony proposed rates that would have resulted in an  
18          average decrease of \$25.26 or 50.28% and a median decrease of \$19.12 or 46.83%.

19          4. For White Tank, the average use (13,906 gallons) residential customer will see an  
20          increase of \$0.14 or 12.57% and the median use (8,994 gallons) residential  
21          customer will see an increase of \$3.96 or 9.89%. The Company's direct testimony  
22          would have resulted in an average increase of \$0.14 or 0.27% and a median  
23          decrease of \$0.32 or 0.8%. Staff's direct testimony proposed rates that would have  
24          resulted in an average decrease of \$5.48 or 10.51% and a median decrease of \$7.66  
25          or 19.14%.

1 **Q. Is there anything you would like to add at this point regarding the rate design for**  
2 **Pinal Valley and Stanfield?**

3 A. Yes. I would like to point out that although the rates proposed in the Agreement for Pinal  
4 Valley and Stanfield average and median usage residential customers are lower than  
5 Staff's proposed direct testimony rates, that does not hold true for residential customers  
6 that use more than the average. For those higher use customers, the proposed rates in the  
7 Agreement are greater than Staff's direct testimony proposed rates. This is due primarily  
8 to the greater spread in the charges between tiers.

9  
10 **Q. As a result of the settlement process did Staff modify its direct testimony**  
11 **recommendation on the rate decrease for Ajo customers?**

12 A. Yes, this was part of the give and take in the settlement process. Although Staff was  
13 willing to give up its position regarding consolidation of Ajo with the other Western  
14 Group systems, Staff wanted to maintain its position of achieving some kind of rate  
15 decrease for the majority of Ajo customers. As stated earlier, the average and median use  
16 for residential customers is 4,764 gallons and 3,201 gallons, respectively. The rate design  
17 proposed for residential customers in the Agreement achieves a rate reduction for  
18 customers using up to approximately 12,000 gallons per month. Therefore, Staff was able  
19 to maintain its position of achieving a rate decrease for the majority of Ajo customers.

20  
21 **Q. As a result of the settlement process did Staff modify its direct testimony**  
22 **recommendation on the rate decrease for White Tank customers?**

23 A. Staff did modify its recommendation, but not as a result of the settlement process. The  
24 primary reason for the rate decrease proposed by Staff in its direct testimony was due to  
25 Staff's proposal to consolidate White Tank with the other Western Group systems. Due to  
26 time constraints on my part, I was not able to discuss the issue of consolidation in detail

1 with Staff prior to the deadline for filing Staff's direct testimony. Once Staff and I were  
2 able to discuss this issue more thoroughly (which was after Staff's direct testimony was  
3 filed), we decided it was not in the public interest to consolidate White Tank at this time.  
4 Therefore, had the parties failed to reach a settlement in this case, Staff would have  
5 proposed in its surrebuttal testimony that White Tank not be consolidated with the other  
6 Western Group systems. The rates that are required to achieve the revenue requirement  
7 for the White Tank system without consolidation are the rates that are proposed in the  
8 Agreement.

9  
10 **Q. Please describe Part V of the Agreement.**

11 A. Part V of the Agreement addresses the issue of rate consolidation. The parties spent a  
12 significant portion of their settlement discussions on the topic of rate consolidation of the  
13 Company's Western Group systems, specifically regarding the Company's, Staff's, and  
14 RUCO's separate positions regarding system consolidation, the Commission's comments  
15 regarding consolidation in the last AWC rate case (Docket No. W-01445A-08-0440,  
16 Decision No. 71845, August 25, 2010), and the Company's consolidation study docketed  
17 in that case. Based on those discussions, the Signatories propose that the Stanfield system  
18 should be fully consolidated with the Pinal Valley system and that the White Tank and  
19 Ajo systems should remain separate and unconsolidated for now.

20  
21 **Q. Please describe Part VI of the Agreement.**

22 A. In this section, AWC agrees to withdraw its request for approval of its proposed  
23 Distribution System Improvement Charge ("DSIC") mechanism, and further agrees not to  
24 raise this request before its next general rate case.

1 **Q. Please describe Part VII of the Agreement.**

2 A. In Part VII, the Signatories propose that: 1) AWC's Off-site Facilities Fee be adopted as  
3 set forth on Exhibit 1 to the Agreement; 2) AWC's Arsenic Cost Recovery Mechanism  
4 ("ACRM") be continued; 3) AWC's Central Arizona Project ("CAP") hook-up fee for the  
5 Company's Casa Grande, Coolidge and White Tank systems be continued without change,  
6 but that the name of this fee be "CAP M&I Fees" in order to more accurately describe the  
7 charges being imposed and avoid ratepayer confusion with other hook-up fee tariffs; 4)  
8 AWC be allowed to accrue Allowance for Funds Used During Construction on land  
9 purchased for the Arizona City water storage tank and booster pump station; and 5) AWC  
10 shall not file its next general rate case for the Western Group or any individual system  
11 within the Western Group until the Company has at least twelve months of actual  
12 experience with the rates approved in this case. In addition, the parties agree that Decision  
13 No. 71845 authorizes AWC to continue to defer its costs associated with implementing  
14 and performing additional Best Management Practices for recovery in a future general rate  
15 case.

16  
17 **SECTION IV - PUBLIC INTEREST**

18 **Q. Mr. Olea, is the Agreement in the public interest?**

19 A. Yes, in Staff's opinion, the Agreement is fair, balanced, and in the public interest.  
20

21 **Q. Would you summarize the reasons that lead Staff to conclude that the Agreement is**  
22 **fair, balanced, and in the public interest?**

23 A. This Agreement results in a settlement package that addresses AWC's needs while  
24 balancing those needs with terms and conditions that provide customer benefits, such as:

- 25 • The Company cannot file its next rate case until the Company has at least twelve  
26 months of actual experience using the rates approved in this case;

- 1           • The Company will adopt the 10.0 percent cost of equity that Staff recommended in
- 2           its direct testimony;<sup>1</sup>
- 3           • Residential Customers for the Pinal Valley, Stanfield and Ajo systems with average
- 4           usage or less will experience a rate decrease;
- 5           • The Company has withdrawn its request to implement a DSIC mechanism;
- 6           • The Company has agreed to larger spreads for its charges between tiers, which
- 7           gives customers more control over their bills.

8

9   **Q.   Mr. Olea, why do you believe it is beneficial to require the Company to have at least**

10 **twelve months of experience with the rates approved in this case before filing its next**

11 **general rate case for the Western Group?**

12   A.   In its initial filing for this case, the Company's application did not contain any actual data

13   using rates approved in its last rate case, because the Company's proposed test year ended

14   prior to the rates from the last case becoming effective. This caused quite a controversy

15   between Staff and the Company, which resulted in much wasted time and effort for both

16   Staff and the Company. In the end, the Company refiled its rate case using six months of

17   actual data under the Company's last approved rates. Having only six months of actual

18   data adds unnecessary difficulty to reviewing a rate application, especially for a company

19   of this size. Staff believes that this provision of the Agreement is beneficial and important

20   to ratepayers not only because it ensures some rate stability for AWC's customers, but

21   also because it should reduce future rate case expense. Providing at least twelve months

22   of experience using the rates approved in this case will allow Staff to properly and

23   adequately analyze and evaluate the Company's application without unnecessary and

24   burdensome pro-forma adjustments.

25

---

<sup>1</sup> See Direct Testimony of Jeffrey M. Michlik at 29 (December 5, 2011).

1 **Q. Please discuss how the Agreement is fair to the utility.**

2 A. The revenue recommended will afford AWC adequate funds to provide reliable and safe  
3 service, while at the same time ensuring the financial health of the Company.

4  
5 **Q. Mr. Olea, what was Staff's goal when it agreed to be a Signatory to the Agreement?**

6 A. The primary goal of Staff in this matter, as in all rate proceedings before the Commission,  
7 is to protect the public interest by recommending rates that are just, fair and reasonable for  
8 both the ratepayers and the Company. Staff believes it has accomplished this by  
9 reviewing the facts presented and making the appropriate recommendations to the  
10 Commission for its consideration, which will balance the interests of the Company and the  
11 ratepayers, by promoting the Commission's desire to ensure that the Company has the  
12 tools and financial health to provide safe, adequate and reliable service, while complying  
13 with Commission requirements of establishing just and reasonable rates.

14  
15 **Q. Is there anything else you would like to add regarding the Agreement?**

16 A. I would like to reiterate that the settlement discussions were transparent, candid,  
17 professional and open to all parties in this docket. All parties were allowed to openly  
18 express their views and opinions on all issues. I believe the Agreement is in the public  
19 interest.

20  
21 **Q. Does this conclude your testimony?**

22 A. Yes.