ORIGINAL

0000137052

RECEIVED
AZ CORP COMMISSION
DOCKET CONTROL

2012 MAY 25 PM 2 58

Arizona Corporation Commission
DOCKETED

MAY 25 2012

DOCKETED BY TM

FENNEMORE CRAIG
A Professional Corporation
Jay L. Shapiro (No. 014650)
3003 North Central Avenue, Suite 2600
Phoenix, Arizona 85012
Telephone (602) 916-5000

Attorneys for Pima Utility Company

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE APPLICATION OF PIMA UTILITY COMPANY, AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE FAIR VALUE OF ITS UTILITY PLANTS AND PROPERTY AND FOR INCREASES IN ITS WATER RATES AND CHARGES FOR UTILITY SERVICE BASED THEREON.	DOCKET NO: W-02199A-11-0329
IN THE MATTER OF THE APPLICATION OF PIMA UTILITY COMPANY, AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE FAIR VALUE OF ITS UTILITY PLANTS AND PROPERTY AND FOR INCREASES IN ITS WASTEWATER RATES AND CHARGES FOR UTILITY SERVICE BASED THEREON.	DOCKET NO: SW-02199A-11-0330 **NOTICE OF FILING**

Pima Utility Company hereby submits this Notice of Filing in the above-referenced matter. Specifically filed herewith are the summaries of the pre-filed testimony of the following witnesses:

1. Ray L. Jones, P.E.;
2. Steve Soriano; and
3. Thomas J. Bourassa.

The Company's final witness, Marc Spitzer, is expected to testify on Thursday, May 31, 2012. His summary will be filed on Tuesday, May 29, 2012.

RESPECTFULLY SUBMITTED this 25th day of May, 2012.

FENNEMORE CRAIG, P.C.

By______________________________

Jay L. Shapiro
3003 North Central Avenue
Suite 2600
Phoenix, Arizona 85012
Attorneys for Pima Utility Company

ORIGINAL and thirteen (13) copies of the foregoing were delivered this 25th day of May, 2012, to:

Docket Control
Arizona Corporation Commission
1200 W. Washington St.
Phoenix, AZ 85007

COPY of the foregoing was delivered this 25th day of May, 2012, to:

Chairman Gary Pierce
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, AZ 85007

Commissioner Paul Newman
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, AZ 85007

Commissioner Sandra D. Kennedy
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, AZ 85007

Commissioner Bob Stump
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, AZ 85007

Commissioner Brenda Burns
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, AZ 85007

John Le Sueur
Advisor to Chairman Gary Pierce
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, AZ 85007

Nancy La Placa
Advisor to Commissioner Paul Newman
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, AZ 85007

Cristina Arzaga-Williams
Advisor to Commissioner Sandra D. Kennedy
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, AZ 85007

Amanda Ho
Advisor to Commissioner Bob Stump
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, AZ 85007

Thomas Galvin
Advisor to Commissioner Brenda Burns
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, AZ 85007

Antonio Gill
Aide to Chairman Gary Pierce
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, AZ 85007

Jennifer Ybarra
Aide to Commissioner Paul Newman
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, AZ 85007

Katherine Nutt
Aide to Commissioner Sandra D. Kennedy
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, AZ 85007

Trisha Morgan
Aide to Commissioner Bob Stump
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, AZ 85007

Tracy Hart
Aide to Commissioner Brenda Burns
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, AZ 85007

Teena Jibilian, ALJ
Hearing Division
Arizona Corporation Commission
1200 W. Washington St.
Phoenix, AZ 85007

Robin Mitchell, Esq.
Scott Hesla, Esq.
Legal Division
Arizona Corporation Commission
1200 W. Washington St.
Phoenix, AZ 85007

Daniel W. Pozefsky
RUCO
1110 W. Washington Street, Suite 220
Phoenix, AZ 85007

By: Maria San Jose
7016443.1/075040.0025

Pima Utility Company
Docket Nos. W-02199A-11-0329 and SW-02199A-11-0330

Ray Jones Testimony Summary

Ray Jones is the owner and principal for ARICOR Water Solutions. He is the former President of Arizona-American Water Company and former Vice President and General Manager of Citizens Water Resources. Mr. Jones is a Registered Professional Engineer specializing in civil engineering and he is a Grade 3 Certified Operator for Water Distribution Systems, Water Treatment Plants, Wastewater Collection Systems and Wastewater Treatment Plants. Mr. Jones' consulting practice specializes in water resource issues, regulatory strategies, rate case filings and water and wastewater utility management and operations.

Mr. Jones will testify in support of Pima Utility Company's ("Pima" or "Company") request to increase rates. Mr. Jones will provide 1) an overview of Pima's water and wastewater system and operations, 2) an overview of the plant additions since Pima's last rate case, 3) support to the B-2 Plant Schedules, and 4) support for the recovery of certain deferred operating costs and income tax expense. Mr. Jones will testify in response to recommendations made by Commission Staff ("Staff") regarding Best Management Practices and the exclusion from rate base of certain costs related to the construction of the Pima Water Reclamation Facility ("Pima WRF").

A summary of Mr. Jones' prefiled testimony follow.

Pima's Wastewater System and Operations

Pima's water and wastewater system is an integrated system serving primarily the unincorporated master planned community of Sun Lakes. Pima's customer base is approximately 96% residential customers, with a small number of commercial customers and irrigation customers. Pima's water system consists of multiple wells and three water storage and booster facilities that provide reliable service. The Pima wastewater treatment system consists of a single 2.4 million gallon per day ("MGD") wastewater reclamation facility. The Pima WRF is a sequential batch reactor facility that includes aerobic digesters, sand filtration and ultra-violet disinfection. The collection system consists of a gravity collection system with fifteen lift stations located at various points in the collection system.

Pima's water and wastewater facilities are well designed, well maintained and provide reliable service to the community. Pima's operations staff is highly knowledgeable regarding water and wastewater system operations and operate the systems in an effective and efficient manner. Pima has implemented five Best

Management Practices and a public education program in accordance with ADWR requirements. Pima's lost and unaccounted for water is consistently under 10%.

Plant Additions Since Last Rate Case

Pima has addressed aging water infrastructure by rehabilitating and rebuilding multiple facilities. Pima has also implemented a service line replacement program to address failing polyethylene water services. Pima has completed the final phase of system integration included in construction of Phase II of the Pima WRF, five recharge/recovery wells and some components of the reclaimed water distribution system. Pima has also made enhancements to the wastewater reclamation facility. The wastewater collection system has also received attention with nine lift stations receiving major improvements or rehabilitation since the last wastewater rate case.

B-2 Plant Schedules

A comprehensive review of Pima's plant records was conducted to verify that Pima's plant records were up to date and accurate. Pima's records were generally in good order and in compliance with the NARUC system of accounts. The recharge and recovery wells were reclassified from the water division to the wastewater division and retirements were brought up to date. All identified discrepancies were corrected and the updated asset entries were used to prepare B-2 Schedule, pages 3.1 to 3.19 for the water division, and pages 3.1 to 3.18 for the wastewater division.

Deferred Operating Costs

Decision No. 59130 authorized deferral of 30% of the increased costs of operating the new wastewater treatment plant (placed in service in 1997) above the cost of operating the old wastewater treatment plant until such time as new rates went into effect. Pima currently seeks recovery of $314,627 in deferred costs incurred during 1998 and 1999. The requested recovery is 30% of the total difference in operating costs of $1,048,756 as prescribed in Decision No. 59130.

Income Tax Expense

Pima is requesting income tax expense because the provision of regulated water and wastewater services gives rise to state and federal income tax. Without income tax recovery, the shareholders of Pima will receive a lower rate of return on their equity investment than shareholders of other corporations that receive income tax recovery. Pima believes the FERC Policy on income tax recovery for pass through tax entities should be adopted because it is comprehensive in scope, well-reasoned and thoroughly vetted.

Response to Staff Recommendation on Best Management Practices

Staff recommends that the Company file at least seven Best Management Practices ("BMPs") in the form of tariffs. Staff's recommendation is duplicative and excessive, taking the Company beyond what is required by ADWR and should be rejected.

Response to Staff's Recommendation to Exclude the Phase II WRF from Rate Base

Staff recommends removal of the Phase II WRF from rate base. Pima does not agree with Staff's recommendation because the Phase II WRF is in service and used and useful in the provision of wastewater treatment by Pima.

Staff's capacity analysis is typically used when there is a mismatch between the customers benefiting from the plant and the customers being asked to pay for the plant. When a mismatch does not exist, as in the case of Pima, a used and useful determination should be made by evaluating the facility components and operations to determine if they are serving and benefiting the customers connected to the plant.

The Pima WRF, including Phase II, is necessary to provide wastewater treatment service to the homes and businesses that are currently connected to the plant. The plant was not designed to serve other homes and businesses yet to come or homes and businesses that never materialized. Staff does not question Pima's prudent decision making, and the Phase II WRF has provided and continues to provide direct and substantial benefits to Pima's current customers and is used and useful in providing wastewater treatment services to those customers. The full cost of the WRF, including Phase 2, should be in rate base.

7013648.5/075040.0025

Pima Utility Company
Docket Nos. W-02199A-11-0329 and SW-02199A-11-0330

Steve Soriano Testimony Summary

Mr. Soriano is employed as a Vice-President for Robson Communities, Inc. He also holds the titles of Vice-President and Assistant Secretary for Pima Utility Company ("Pima"), and functions as Pima's General Manager. Robson Communities, Inc. provides accounting and administrative services to a group of affiliated companies collectively referred to as "Robson." Pima provides water and wastewater utility services to the Sun Lakes community (developed by Robson) and two additional small adjacent subdivisions to Sun Lakes.

As Vice-President and Assistant Secretary for Pima, Mr. Soriano oversees the operations and business management functions for Pima. He is responsible for the daily operations and administration of the utility, for the financial and operating results, for capital and operating cost budgeting, for rate case planning and oversight, and for rate setting policies and procedures.

Mr. Soriano will testify regarding Pima's need for rate relief as well as the significant improvements made to Pima's plant and facilities. He will also address the status of Pima's debt financing, and the issues of rate case expense, recovery of income taxes, and the proposed salary amount for the CEO and Board Chairman. Specifically, among other things, Mr. Soriano will testify that:

- Pima is in compliance with the rules and regulations of ADEQ, ADWR, Maricopa County, and the Commission.

- Pima is in the process of reviewing the first draft of a credit agreement and related loan documents. It is estimated that (as of April 25, 2012) Pima is somewhere between 60 and 90 days from closing the loan. The final interest rate will be around 4.25 percent, which is noticeably lower than the maximum 5.5 percent authorized by the Commission.

- Pima is adopting RUCO's suggested rate case surcharge mechanism because rate case expense is an expense incurred outside the test year and before new rates go into effect that can and should be subject to a mechanism that ensures no over- or under-recovery.

- Pima was formed in 1972 as an S corporation, a pass-through entity. It seems inequitable to Pima and its shareholders that its perfectly legitimate election of a corporate form that has no detrimental impact on customers should lead to discounted rates at the expense of those shareholders. But for the provision of service, there would be no tax liability.

- Changing the status of an existing corporation can have impacts to the corporation and its shareholders that need to be fully understood prior to making a change. Pima is also mindful that converting to an entity such as a C corporation will result in higher taxes on Pima's income and thereafter higher rates for its customers.

- Mr. Robson is the CEO and Chairman of Pima. He oversees and is ultimately responsible for water and sewer utility with 20,000 customers by an entity grossing over $6 million annually. A salary for Mr. Robson was approved in the last rate case. His role and involvement in Pima's operations has not changed. Pima simply indexed the salary approved in the last rate case to reflect inflation and the increase in customers at Pima. A total salary of $80,000 for Mr. Robson is fair and reasonable.

7013833.3/075040.0025

Pima Utility Company
Docket Nos. W-02199A-11-0329 and SW-02199A-11-0330

<u>Thomas J. Bourassa Testimony Summary</u>

Thomas J. Bourassa is a Certified Public Accountant who provides consulting services to public utilities. He has testified on numerous occasions before the Arizona Corporation Commission (the "Commission") on behalf of Arizona water and wastewater utilities. In this case he is testifying on behalf of Pima Utility ("the Company") on the topics of the Company's rate base, its income statement (i.e., revenue and operating expenses), its required increase in revenue and its rate design and proposed rates and charges for service. Mr. Bourassa is testifying on the cost of capital, including the cost of equity.

<u>Overview of the Company's Request Rate Relief</u>

The Company is requesting a gross revenue increase of $712,426 for its water division, which is an increase of approximately 36.03 percent over test year (ended December 31, 2010) revenues, and an increase of $416,275 for its wastewater division, which is an increase of approximately 13.44 percent over test year (ended December 31, 2010) revenues. The following is a summary of the Company's water and wastewater division revenue requirement:

	Water	Wastewater
Fair Value Rate Base	$ 9,073,324	$ 9,832,800
Adjusted Operating Income	$ 242,546	$ 517,362
Current Rate of Return	2.67%	5.26%
Required Operating Income	$ 752,179	$ 815,139
Required Rate of Return	8.29%	8.29%
Operating Income Deficiency	$ 509,633	$ 297,777
Gross Revenue Conversion Factor	1.3979	1.3979
Increase in Gross Revenues	$ 712,426	$ 416,275

For the water division, the Company is proposing an inverted tier rate design to promote conservation and which recognizes a move towards rates that reflect each customer class paying its cost of service. The Company proposed rate design balances the risk of not recovering its revenue requirement with risk of revenue loss from conservation (revenue stability). Under the Company's water division proposed rates, a typical 5/8x3/4 inch metered residential customer would experience an increase of $3.08 (about 28.87 percent), from $10.66 per month to $13.74 per month.

For the wastewater division, the Company is adopting the same rate design approved by the Commission in the Company's prior rate case. Under the Company's wastewater division proposed rates, a typical residential customer would experience an increase of $3.30 (about 14.5 percent), from $22.73 per month to $26.03 per month.

There are a relatively few number of issues in dispute in this case. The Company has accepted many of the adjustments proposed by Staff and RUCO in order to reduce disputes and simplify the rate case. The following is a brief summary of the major unresolved issues.

Rate Base Issues - Water

1. Advances-in-Aid of Construction ("AIAC") and Contributions-in-Aid of Construction ("CIAC"). The Company has adopted RUCO's recommendation to reclassify $374,326 of AIAC and un-refunded AIAC in accounts payable of $49,353 to CIAC because the developer is bankrupt and the Company is unlikely to repay the AIAC. Staff has not accepted this adjustment.

Rate Base Issues – Wastewater

1. Advances-in-Aid of Construction ("AIAC") and Contributions-in-aid of Construction ("CIAC"). The Company has adopted RUCO's recommendation to reclassify $285,313 of AIAC and un-refunded AIAC in accounts payable of $58,099 to CIAC because the developer is bankrupt and the Company is unlikely to repay the AIAC. Staff has not accepted this adjustment.

2. Excess Capacity. The Company has not adopted Staff's recommendation to reduce plant costs by $598,468 and accumulated depreciation by $356,088 for what Staff deems as excess capacity related costs. RUCO has also not adopted this Staff adjustment.

2. Prior Case Plant Costs. The Company has adopted a $37,858 adjustment to plant-in-service related to prior rate case costs along an associated adjustment to accumulated depreciation. Staff has not adopted this adjustment.

Revenue and Income Statement Issues – Water and Wastewater Division

1. Rate Case Expense. The Company proposes $200,000 of rate case expense for each division with a recovery over 5 years, or $40,000 annually. The Company proposes to recover rate case expense via a surcharge rather than including rate case expense in the revenue requirement and base rates. The Company believes this approach will prevent over/under recovery of rate case expense.

2. Salaries and Wages – Officers and Directors. The Company proposes an annual cost of $40,198 for each division for Mr. Robson, CEO and Chairman of the Board. Staff recommends $13,686 for each division. RUCO recommends $7,085 for each division.

3. Miscellaneous Expense. The Company has adopted RUCO's recommendation to reclassify bank related fees from the water division to the wastewater division. Staff has not adopted this adjustment.

4. Income Taxes. The Company proposes an income tax allowance for each division. Both Staff and RUCO oppose an income tax allowance.

Rate Design and Proposed Rates – Water Division

The Company proposes an inverted tier rate design which consists of a three tier design for smaller metered residential customers and a two tier design for smaller metered commercial and irrigation customers, as well as larger metered customers (all classes). Staff and RUCO propose similar designs. The Company and the Staff rate designs place more emphasis on revenue recovery from the monthly minimums than does the RUCO rate design. The emphasis on revenue recovery from the monthly minimums helps to achieve a better balance between revenue stability and conservation.

The Company has used its cost of service study to help design rates which are more reflective of the cost of service. The Company's rate design provides the least subsidization of the small residential customers when compared to the Staff rate design.

At the Company's proposed revenue level, rates for average 5/8x3/4 residential customers will increase by approximately $3.08 (from $10.66 to $13.74) or approximately 28.87 percent.

Rate Design and Proposed Rates – Wastewater Division

The Company's rate design is the same basic rate design currently in effect which primarily reflects a flat rate design for residential and commercial customers. Both Staff and RUCO propose rate designs similar to the Company.

One area of disagreement is that Staff increases the monthly minimum on only the 5/8x3/4 inch meters. The Company and RUCO increase the monthly minimums for all meter sizes evenly.

A second area of disagreement is that the Company sets the effluent and recovered effluent water rates the same as the irrigation class for water division which reflects the integrated nature of the Company's water and wastewater operations. Staff and RUCO propose rates which are different between water and wastewater.

At the Company's proposed revenue level, rates for average 5/8x3/4 residential customers will increase by $3.30 (from $22.73 to $26.03) or approximately 14.50 percent.

Cost of Equity and WACC

Mr. Bourassa performed estimates of the cost of equity using the Commission's preferred models, the Discounted Cash Flow ("DCF") model and the Capital Asset Pricing Model ("CAPM"). Mr. Bourassa's updated estimate of the cost of equity is 10.5 percent and a cost of debt of 4.25 percent. The Company proposes a 35.4 percent debt and 64.6 percent equity capital structure. Accordingly, weighted cost of capital ("WACC") is 8.29 percent.

Mr. Bourassa's recommendation of 10.5 percent is conservative when compared to current book returns, currently authorized returns, projected returns for the publicly traded water utilities, and the results using the build-up method; one using *Value Line* data and the other using the *Duff and Phelps* risk premium study data. Based on these checks of reasonableness, Mr. Bourassa believes the recommendation of Staff and RUCO are far too low.

7016547.2/075040.0025