

ORIGINAL

OPEN MEETING AGENDA ITEM



0000143970

COMMISSIONERS

- Bob Stump - Chairman
- Gary Pierce
- Brenda Burns
- Susan Bitter Smith
- Bob Burns

BEFORE THE ARIZONA CORPORATION COMMISSION

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 EASTERN GROUP AND FOR CERTAIN RELATED APPROVALS.

DOCKET NO. W-01445A-11-0310

**NOTICE OF FILING
TESTIMONY IN SUPPORT
OF SETTLEMENT AGREEMENT
(PHASE 2-DSIC)**

Arizona Water Company hereby files the Testimony of Joel M. Reiker in support of settlement in the above-captioned docket.

RESPECTFULLY SUBMITTED this 2nd day of April, 2013.

ARIZONA WATER COMPANY

Arizona Corporation Commission

DOCKETED

APR 02 2013

DOCKETED BY *DM*
WM

By: *Joel M. Reiker*

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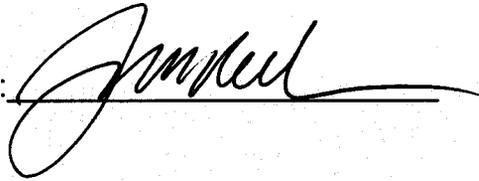
By: 

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1 **ARIZONA WATER COMPANY**

2
3 **Testimony of**
4 **Joel M. Reiker**

5 **I. Introduction**

6 **Q. PLEASE STATE YOUR NAME, EMPLOYER AND TITLE.**

7 A. My name is Joel M. Reiker. I am employed by Arizona Water Company (the
8 "Company") as Vice President – Rates and Revenues.

9 **Q. ARE YOU THE SAME JOEL M. REIKER THAT PREVIOUSLY PROVIDED**
10 **DIRECT, REBUTTAL AND REJOINDER TESTIMONY IN THIS PROCEEDING?**

11 A. Yes.

12 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

13 A. The purpose of my testimony is to support the proposed Settlement Agreement
14 Regarding Distribution System Improvement Charges ("DSIC") and Other DSIC-
15 Like Proposals ("Settlement Agreement") filed on April 1, 2013, in this
16 proceeding.

17 **II. Settlement Process**

18 **Q. PLEASE PROVIDE A SUMMARY OF THIS PROCEEDING AS IT RELATES TO**
19 **THE SETTLEMENT AGREEMENT.**

20 A. On August 5, 2011, the Company filed an application with the Arizona
21 Corporation Commission ("Commission") for an increase in the rates and
22 charges for utility service provided by its Eastern Group of water systems. The
23 Company's Eastern Group includes the Superstition (Apache Junction, Superior
24 and Miami), Cochise (Bisbee and Sierra Vista), San Manuel, Falcon Valley
25 (Oracle and SaddleBrooke Ranch) and Winkelman systems. In addition to its
26 request for a general rate increase, the Company sought, among other relief,
27 authorization to implement a DSIC in its Eastern Group.
28

1 Testimony was filed by the Company, the Arizona Corporation
2 Commission's Utilities Division Staff ("Staff") and the Residential Utility Consumer
3 Office ("RUCO"). Intervention was also granted to Kathie Wyatt, although Ms.
4 Wyatt did not participate in the proceedings.

5 Evidentiary hearings commenced on May 14, 2012, and closed on May
6 24, 2012. Following post-hearing briefing, the Administrative Law Judge issued a
7 Recommended Opinion and Order ("ROO") on January 30, 2013. The Company
8 and RUCO filed exceptions to the ROO and Staff responded to the Company's
9 exceptions. In addition, amendments to the ROO were presented at the Open
10 Meeting during which the Commission considered the ROO on February 12,
11 2013. At that Open Meeting, following substantial discussion, deliberation, and
12 review of public testimony and the arguments of the parties, the Commission
13 voted to adopt the ROO, as amended, resulting in Decision No. 73736. Although
14 the Commission stated that it was supportive of a DSIC-type mechanism, it did
15 not authorize a DSIC for the Company's Eastern Group in Decision No. 73736.¹

16 **Q. HOW WAS THE ROO AMENDED?**

17 **A.** As it relates to the Settlement Agreement, the ROO was amended such that
18 Decision No. 73736 provided for the reopening of intervention for the limited
19 purpose of discussing the Company's DSIC proposal. Specifically, the
20 Commission stated:

21 Although we will not authorize a DSIC herein, today,
22 we are supportive of the DSIC type mechanism and
23 therefore we will leave this Docket open to allow the parties
24 the opportunity to enter into discussions regarding AWC's
25 DSIC proposal and other DSIC like proposals Staff may wish
26 to introduce.

27
28

¹ See Decision No. 73736, dated February 20, 2013. p. 104, lines 22 – 25.

1 In order to allow other parties that may be interested
2 in this issue the ability to have input, we will allow such
3 parties the opportunity to request late intervention in this
4 Docket for the specific and limited purpose of participating in
5 proceedings addressing [DSIC and other DSIC-like
6 proposals]. ... The Hearing Division shall issue a proposed
7 Order on this matter such that it may be considered by the
8 Commission no later than its Open Meeting on June 11 and
9 12, 2013.²

10 Accordingly, the Administrative Law Judge issued Procedural Orders on
11 February 21, February 25, and March 21, 2013, setting forth procedural
12 deadlines related to what is now referred to as Phase-2 of Docket No. 11-0310.
13 The Settlement Agreement is the result of Phase-2 settlement discussions.

14 **Q. DID ANY PARTIES INTERVENE IN PHASE-2?**

15 **A.** Yes. The following entities intervened for the purpose of discussing the
16 Company's DSIC proposal and other DSIC-like mechanisms:

- 17 • Global Water – Palo Verde Utilities Company, Global Water – Santa Cruz
18 Water Company, Valencia Water Company – Town Division, Valencia
19 Water Company – Greater Buckeye Division, Water Utility of Greater
20 Tonopah, Willow Valley Water Co. and Water Utility of Northern
21 Scottsdale (collectively referred to as the "Global Utilities").
- 22 • EPCOR Water Arizona Inc. ("EPCOR")
- 23 • Rio Rico Utilities, Inc. dba Liberty Utilities ("Liberty Utilities")
- 24 • The Water Utility Association of Arizona ("WUAA")
- 25 • Arizona Investment Council ("AIC")
- 26 • City of Globe

27 **Q. HOW WAS THE SETTLEMENT PROCESS CONDUCTED?**

28 ² See Decision No. 73736, dated February 20, 2013. P. 104, line 26 – p. 25, line 3.

1 A. Staff notified all parties to this proceeding of the settlement discussions on
2 February 21, 2013, and formal settlement discussions commenced on March 4,
3 2013. The settlement discussions included the Company, Staff, RUCO, Global
4 Utilities, EPCOR, Liberty Utilities, AIC and the City of Globe.³ The settlement
5 discussions were open, transparent, and inclusive of all participating parties, with
6 each such party having an equal opportunity to participate. As is the nature of all
7 settlement negotiations and resulting compromises, no one party received
8 everything they wanted. Instead, the parties agreed upon a conceptual
9 compromise that when viewed as a whole, was in the best interests of all parties.

10 The parties then drafted and circulated a proposed Settlement Agreement
11 reflecting the agreements reached in the March 4, 2013, meetings, which led to
12 further communications and negotiations regarding the specific terms. On March
13 26, 2013, following multiple exchanges of drafts and discussions among the
14 parties, the parties and the majority of the intervenors and their counsel met
15 again at the Commission's offices and finalized the terms of the Settlement
16 Agreement.

17 The Company believes the Settlement Agreement represents a balanced
18 and complete package that will promote the public interest and provide for a
19 prompt resolution of the DSIC issue while avoiding the expense associated with
20 delay and continued litigation of the Phase-2 proceedings.

21 **Q. WHICH OF THE PARTIES TO THIS PROCEEDING ARE SIGNATORIES TO**
22 **THE SETTLEMENT AGREEMENT?**

23 A. The Company, Staff, Global Utilities, EPCOR, Liberty Utilities, WUAA and AIC
24 (collectively referred to as the "Signatory Parties") are signatories to the
25 Settlement Agreement.

26
27
28 ³ Neither WUAA nor Kathie Wyatt participated in the settlement discussions.

1 **III. Distribution System Improvement Charge ("DSIC") and the System**
2 **Improvement Benefits ("SIB") Mechanism**

3 **Q. PLEASE EXPLAIN THE DSIC AS ORIGINALLY PROPOSED BY THE**
4 **COMPANY.**

5 A. As more fully explained by Company witness Joseph D. Harris in Section VI of
6 his pre-filed direct testimony filed on August 5, 2011, in this proceeding, a DSIC
7 is a ratemaking tool that provides for the recovery of the capital costs (i.e.
8 depreciation expense and pre-tax return on investment) associated with non-
9 revenue producing distribution system improvement projects completed between
10 general rate cases. The Company first requested a DSIC in its last total-
11 Company general rate case (Docket No. W-01445A-08-0440). While the
12 Commission did not approve a DSIC in that proceeding, it stated in Decision No.
13 71845 (dated August 24, 2010), that an infrastructure funding mechanism may
14 be reasonable for certain of the Company's aging systems that face unique
15 challenges. The Commission further stated its belief that it was appropriate for
16 the Company to further develop the issue for future consideration by preparing a
17 study and filing a report on DSIC, and to utilize the information from that study to
18 inform the Commission in future rate cases.

19 **Q. DID THE COMPANY PREPARE AND FILE SUCH A STUDY?**

20 A. Yes. The Company filed its original DSIC study in Docket No. 08-0440 on July
21 22, 2011. The DSIC study is also attached as Exhibit JDH-3 to Mr. Harris' pre-
22 filed direct testimony in this proceeding. The Company's DSIC study details the
23 history of the DSIC, the need for distribution system improvements, the cost of
24 those improvements, the potential rate impacts, and the benefits associated with
25 such a mechanism.

26 **Q. PLEASE EXPLAIN THE SETTLEMENT AGREEMENT'S RESOLUTION OF**
27 **THE COMPANY'S DSIC PROPOSAL.**

1 A. The Signatory Parties agree that both the timing and magnitude of certain
2 infrastructure improvements the Company must undertake in order to maintain
3 adequate and reliable service to its customers create a circumstance justifying a
4 DSIC-type mechanism in this case. The Signatory Parties also agree that a
5 DSIC-type mechanism is an appropriate means for allowing the Company the
6 opportunity to make such improvements while reducing the negative financial
7 impact on the Company and providing benefits to customers. Additionally, the
8 mechanism developed by the Signatory Parties and proposed herein can serve
9 as a template in future proceedings, where appropriate. Accordingly, the
10 Signatory Parties, through the process of negotiation, developed a "System
11 Improvement Benefits" ("SIB") mechanism. The SIB mechanism is substantially
12 similar to DSIC and DSIC-type mechanisms that have been approved in other
13 states in that it allows for the timely recovery of the capital costs associated with
14 certain infrastructure replacements completed and placed in service between
15 general rate cases. The mechanics of the SIB mechanism were developed
16 under a collaborative effort of the Signatory Parties who, collectively, benefit from
17 expertise in several areas of regulation and ratemaking.

18 **Q. PLEASE PROVIDE A SUMMARY OF THE SIB MECHANISM PROPOSED IN**
19 **THE SETTLEMENT AGREEMENT.**

20 A. The Signatory Parties developed a number of key provisions to the SIB
21 mechanism that appropriately balance the interests of the Company and its
22 customers. The major provisions are:

- 23 • Commission Pre-Approval of SIB-Eligible Projects – All of the
24 infrastructure replacement projects contemplated for SIB recovery must be
25 approved by the Commission prior to the Company filing for recovery of
26 the capital costs associated with such projects. The specific projects the
27 Company proposes for SIB treatment in this proceeding are listed in SIB
28 Plant Table I, attached to the Settlement Agreement as Exhibit A. All of

1 the Commission-approved projects that are included in a SIB surcharge
2 filing must be completed and placed in service prior to the SIB surcharge
3 going into effect. If circumstances require the Company to undertake a
4 qualifying project that is not on the list of SIB-eligible projects, it may seek
5 Commission approval to add such project to the list. Additionally, Section
6 4.8 of the Settlement Agreement requires the Company to file a report with
7 the Commission every six months summarizing the status of all SIB-
8 eligible projects.

- 9 • SIB Project Eligibility Criteria – Only those projects completed for the
10 purpose of maintaining or improving existing customer service and
11 reliability, integrity and safety are eligible for SIB treatment. Projects
12 designed to extend existing facilities or expand capacity to serve new
13 customers are not eligible for SIB treatment.
- 14 • Costs Eligible for SIB Recovery – The project costs that are eligible for
15 SIB surcharge recovery are limited to the pre-tax rate of return on
16 investment and depreciation expense associated with SIB-eligible
17 projects. The rate of return, depreciation rate, and tax multiplier are equal
18 to those approved by the Commission in the Company's most recent
19 general rate case – in this case Decision No. 73736. The calculation of
20 the SIB surcharge will also take into account any related plant retirements.
- 21 • Efficiency Credit – A credit equal to five percent of the SIB surcharge will
22 be given back to customers in the form of a SIB efficiency credit.
- 23 • SIB Surcharge Cap – The amount to be collected from each SIB
24 surcharge is capped annually at five percent of the revenue requirement
25 authorized in the Company's most recent general rate case.
- 26 • SIB Surcharge Rate Design – The SIB surcharge will be a fixed monthly
27 surcharge presented on customers' bills as a SIB fixed surcharge and SIB
28

1 efficiency credit as two separate line-items. The surcharge will increase
2 with meter size based on the flow capacity of the meter.

- 3 • Commission Approval of SIB Surcharge – Each SIB surcharge filing must
4 be approved by the Commission prior to the Company implementing such
5 surcharge. To this end, the Company will include a proposed order for the
6 Commission's consideration with each SIB surcharge filing. When the
7 Company files a SIB surcharge, Staff and RUCO will have 30 days to
8 review the filing and, if no objection is raised, the surcharge will be placed
9 on an open meeting agenda at the earliest practicable date.
- 10 • Number of SIB Surcharge Filings Allowed Between General Rate Cases –
11 The Company may file up to five SIB surcharges between general rate
12 cases, with the initial filing being no sooner than 12 months after the date
13 of the Commission's decision in its most recent general rate case. The
14 Company may file no more than one SIB surcharge every 12 months.
15 Additionally, the Company must file its next general rate case no later than
16 five years after its most recent general rate case, at which time any SIB
17 surcharges that are in effect will end and the associated costs will be
18 included in base rates.
- 19 • Annual SIB True-up – For each 12-month period that a SIB surcharge is in
20 effect, the Company will reconcile the revenue collected with the SIB
21 revenue authorized for that period. Any over- or under-collected SIB
22 surcharge revenues will be refunded, or collected, as appropriate over the
23 subsequent 12-month period.
- 24 • Public Notice – At least 30 days prior to a SIB surcharge becoming
25 effective, the Company will provide public notice in the form of a billing
26 insert or customer letter that summarizes the amount of the SIB
27 surcharge, SIB efficiency credit, any true-up, as well as a summary of the
28 projects included in the surcharge and their associated cost.

1 Q. DOES STAFF AGREE THAT THE INFRASTRUCTURE REPLACEMENT
2 PROJECTS LISTED IN SIB PLANT TABLE I (EXHIBIT A TO THE
3 SETTLEMENT AGREEMENT) ARE APPROPRIATE AND ELIGIBLE FOR SIB
4 TREATMENT IN THIS PROCEEDING?

5 A. Yes. Staff agrees with the Company's proposed list of SIB-eligible projects
6 shown in SIB Plant Table I, attached to the Settlement Agreement as Exhibit A.

7 Q. WHEN DOES THE COMPANY CONTEMPLATE MAKING ITS FIRST SIB
8 SURCHARGE FILING?

9 A. Section 4.2 of the Settlement Agreement provides that the Company cannot file
10 its first SIB surcharge any sooner than 12 months after the date of Decision No.
11 73736, dated February 20, 2013. Accordingly, the Company plans to make its
12 first SIB surcharge filing on or about February 20, 2014.

13 Q. WHAT IS THE ESTIMATED MAXIMUM IMPACT OF THE SIB SURCHARGE
14 ON THE AVERAGE RESIDENTIAL CUSTOMER'S BILL IN EACH OF THE
15 WATER SYSTEMS IN THE EASTERN GROUP THAT THE COMPANY
16 CONTEMPLATES IMPLEMENTING THE SIB MECHANISM?

17 A. The table shown in Exhibit JMR-1, attached to this testimony, summarizes the
18 estimated maximum impact of the SIB surcharge on the average residential
19 customer's monthly bill, based the SIB surcharge cap of five percent. As shown
20 in Exhibit JMR-1, the estimated maximum impact on the average residential
21 customer's monthly bill ranges from 5.08% (San Manuel) to 6.46% (Sierra Vista).

22 **IV. SIB Mechanism Benefits**

23 Q. WHAT TYPES OF BENEFITS ARE ASSOCIATED WITH THE SIB
24 MECHANISM AS SET FORTH IN THE SETTLEMENT AGREEMENT?

25 A. The SIB mechanism will reduce regulatory lag for the most critical types of capital
26 projects – the replacement of aging and failing infrastructure. The Company
27 must have the ability to recover costs in a timely manner in order to remain
28 financially viable and undertake the infrastructure replacement projects that are

1 required in the coming years. The SIB mechanism will reduce regulatory lag and
2 help to maintain the Company's financial integrity, which will promote the
3 investment in replacement infrastructure. As explained by Company witness
4 Pauline M. Ahern in her pre-filed rebuttal testimony filed on April 10, 2012 in this
5 proceeding, two of the major bond/credit rating agencies in the U.S., Moody's
6 and Standard and Poor's, agree that infrastructure replacement mechanisms
7 such as the one embodied in the Settlement Agreement are credit supportive and
8 serve to maintain the financial integrity of utilities facing major capital
9 expenditures.

10 **Q. DO CUSTOMERS BENEFIT FROM A UTILITY'S ABILITY TO RECOVER**
11 **COSTS IN A TIMELY MANNER?**

12 **A.** Yes. If a utility's rates are consistently lower than cost, the owners of that utility
13 are forced to subsidize the provision of service – a situation that is not
14 sustainable in the long-term.

15 **Q. WILL CUSTOMERS BENEFIT IN OTHER WAYS?**

16 **A.** Yes. The Settlement Agreement allows for the replacement of aging and failing
17 infrastructure, and because the Company places a priority on the most
18 problematic areas, customers in those areas will see prompt improvements in
19 water quality, fire protection, water loss, water pressure and frequency of service
20 interruptions. As explained by Mr. Harris in Section VI of his direct testimony,
21 failing distribution infrastructure causes a number of customer service
22 issues such as degradation of water quality and service interruptions. Service
23 interruptions can affect hundreds of customers at one time, and leaking water
24 mains and services result in millions of gallons of potable water failing to reach
25 customers every year.

26 Customer benefits are not limited to quality of service. Rate stability is
27 also important to customers and the SIB mechanism will help to limit rate
28 increases to smaller, more regularly timed increases as opposed to much larger

1 increases that frequently occur absent such a mechanism. Also, because the
2 Company operates in a rising-cost industry, delaying an infrastructure
3 replacement project means that it will ultimately cost more than it would if the
4 Company was able to undertake it earlier. With the SIB mechanism the
5 Company will be able to replace infrastructure sooner rather than later, and at a
6 lower cost. The SIB mechanism will also help to mitigate rising operations and
7 maintenance costs in the long-term as a result of improved infrastructure.
8 Finally, in addition to the cost discounts that are already built into residential
9 rates, customers will receive an efficiency credit on their bills equal to five
10 percent of the cost of SIB-eligible projects.

11 **Q. CAN CUSTOMERS OF OTHER ARIZONA WATER AND WASTEWATER**
12 **UTILITIES BENEFIT FROM THE SETTLEMENT AGREEMENT?**

13 A. Yes. Not all of the parties participating in this proceeding are Signatories to the
14 Settlement Agreement. Nevertheless, the Settlement Agreement reflects the
15 thoughtful input and expertise offered by RUCO, as well as representatives of
16 Global Utilities, EPCOR and Liberty Utilities. As a result, the Settlement
17 Agreement can serve as a template for the Commission in other proceedings,
18 similar to the Arsenic Cost Recovery Mechanism.

19 **Q. IS THE SIB MECHANISM A FULL COST RECOVERY MECHANISM?**

20 A. No. As mentioned above, the SIB mechanism includes a customer efficiency
21 credit, which makes it only a partial cost recovery mechanism. As a matter of
22 comparison, the Company's cost of common equity, as determined by the
23 Commission in Decision No. 73736, is 10.55 percent. As a result of the
24 efficiency credit, the *effective* return on common equity that the Company will
25 earn on SIB-eligible projects is only 9.55 percent - 100 basis points *lower* than
26 what the Commission determined the Company's cost of equity to be in Decision
27 No. 73736. Further, while the SIB mechanism will serve to alleviate the
28 regulatory lag associated with certain plant replacements, it will not eliminate it.

1 The fact remains that the Company will continue to under-recover its cost of
2 providing utility service. Nevertheless, the SIB mechanism is significant step in
3 the right direction.

4 V. **Public Interest**

5 Q. PLEASE EXPLAIN WHY THE COMMISSION'S APPROVAL OF THE
6 SETTLEMENT AGREEMENT RESULTS IN RATES, CHARGES AND
7 CONDITIONS OF SERVICE THAT ARE JUST AND REASONABLE AND IN
8 THE PUBLIC INTEREST.

9 A. In the context of utility regulation, a just and reasonable rate is one that provides
10 the utility an opportunity to recover no less, and no more, than its cost of
11 providing service, including the cost of the capital deployed in the provision of
12 such service. The Settlement Agreement provides for the *partial* recovery of
13 known and measurable costs and, while not a full-cost recovery mechanism, as
14 mentioned above it represents a step in the right direction. The SIB mechanism
15 also includes various regulatory safeguards intended to ensure the Company
16 does not earn excessive returns. These safeguards include a revenue cap,
17 customer efficiency credit, annual true-up and a requirement to file a future
18 general rate case within a specified time period. In addition, Staff and RUCO will
19 have the opportunity to review all SIB-eligible projects, their associated costs and
20 the resulting impact on customers. Finally, the Commission retains ultimate
21 authority over the rates charged pursuant to the SIB mechanism and, as
22 described in Section 10 of the Settlement Agreement, may determine that good
23 cause exists to suspend, terminate or modify the SIB mechanism as it deems
24 appropriate.

25 Q. DOES THAT CONCLUDE YOUR TESTIMONY IN SUPPORT OF THE
26 AGREEMENT?

27 A. Yes.

EXHIBIT JMR-1

ARIZONA WATER COMPANY

RESIDENTIAL CUSTOMER BILL ANALYSIS (5/8-INCH X 3/4-INCH)
ESTIMATED MAXIMUM IMPACT OF THE SIB SURCHARGE

	Average Usage in Gallons	Current Monthly Bill	SIB Surcharge	SIB Efficiency Credit	Total Bill with SIB & Efficiency Credit	Net Bill Increase	Percentage Increase
Superstition	6,321	\$ 38.21	\$ 2.38	\$ (0.12)	\$ 40.47	\$ 2.26	5.93%
Cochise - Bisbee	4,832	\$ 31.88	\$ 2.06	\$ (0.10)	\$ 33.83	\$ 1.95	6.13%
Cochise - Sierra Vista	7,995	\$ 30.25	\$ 2.06	\$ (0.10)	\$ 32.20	\$ 1.95	6.46%
Falcon Valley	5,140	\$ 46.45	\$ 2.50	\$ (0.13)	\$ 48.83	\$ 2.38	5.12%
San Manuel	7,139	\$ 51.94	\$ 2.77	\$ (0.14)	\$ 54.58	\$ 2.64	5.08%
Winkelman	9,398	\$ 33.81	\$ 2.12	\$ (0.11)	\$ 35.82	\$ 2.01	5.94%