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BEFORE THE ARIZONA CORPORATION COMMISSION

AZ CORP COMMISSION
DOCKET CONTROL

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COMMISSIONERS

BOB STUMP - Chairman
GARY PIERCE
BRENDA BURNS
BOB BURNS
SUSAN BITTER SMITH

IN THE MATTER OF THE APPLICATION OF
NEW RIVER UTILITY COMPANY, AN
ARIZONA CORPORATION, FOR A
DETERMINATION OF THE FAIR VALUE
OF ITS UTILITY PLANT AND
PROPERTY AND FOR INCREASES IN
ITS WATER RATES AND CHARGES FOR
UTILITY SERVICE BASED THEREON.

DOCKET NO. W-01737A-12-0478

Arizona Corporation Commission
DOCKETED

OCT 25 2013

DOCKETED BY

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INITIAL CLOSING BRIEF OF NEW RIVER UTILITY COMPANY

OCTOBER 25, 2013

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1 **I. INTRODUCTION**

2 New River Utility Company (“New River” or the “Company”) hereby submits its Initial
3 Closing Brief in the above-captioned docket. New River’s current rates and charges were
4 approved by the Arizona Corporation Commission (“Commission”) in Decision 65134, based
5 upon a test year ended December 31, 2000. The rates went into effect on September 1, 2002.
6 Operating expenses and rate base have both increased since the last test year. Thus, revenues
7 from New River’s utility operations are presently inadequate to allow the Company to recover its
8 operating costs and earn a just and reasonable rate of return on the fair value of its utility plant
9 devoted to public service.

10 During the test year, New River’s adjusted gross revenues were \$1,260,429 as stated in
11 the Company’s rate application in this docket. Adjusted operating income was \$3,629, leading to
12 an operating income deficiency of \$677,580. The adjusted fair value rate base was \$7,812,036.
13 The rate of return during the test year was 0.05%.

14 In its application, New River requested an increase in gross revenues of \$1,087,457, an
15 increase of 86.28%. Based upon the adjustments recommended by Utilities Division Staff which
16 have been accepted by the Company, New River now seeks an increase in gross revenue of
17 \$761,820, an increase of 60.44%. The Company is proposing an adjusted fair value rate base of
18 \$6,729,925.

19 In a spirit of cooperation, New River has agreed to a large majority of the adjustments
20 proposed by Staff in this case. Through discovery, the parties have significantly narrowed the
21 issue to be resolved. The difference between the parties on test year fair value rate base stands at
22 \$308,209. The difference between the parties on test year expenses has been narrowed to
23 \$100,509.

24 However, there remain a number of adjustments where Staff has taken arbitrary and/or
25 punitive positions. In some cases, Staff has substituted its judgment for that of the Company’s
26 management. For example, Staff has removed the cost of one of the Company’s four work
27 vehicles from expenses. Staff has arbitrarily reduced the rental expense for a portion of the
28 Company’s workshop space and its business office. Staff has reduced the Company’s actual test

1 year bad debt expense by two-thirds. Staff has refused to recognize the expense of significant
2 water storage tank recoating work that will begin shortly.

3 With respect to the Company's rate base, Staff has removed 100% of plant that was not
4 adequately supported with invoices, rather than removing only a percentage of such plant. Staff's
5 proposed cost of equity at 8.9% is simply too low and is out of line with the recent rate orders and
6 Staff recommendations. Staff's proposed rate design is so heavily skewed to the top rate tier that
7 it ensures the Company will not earn its authorized rate of return.

8 The disputed adjustments and recommendations of Staff, if adopted, will result in rates
9 that are not just and reasonable. New River requests that the Administrative Law Judge ("ALJ")
10 issue her order rejecting such adjustments and recommendations, and accepting the Company's
11 proposed rate base, expenses, cost of capital and rate design.

12 **II. RATE BASE ISSUES.**

13 The positions of New River and Staff regarding rate base are set forth in Table 1 below:

14 **Table 1-Rate Base¹**

	Staff	New River	Difference
15 Rate Base (Original Cost)	\$2,225,725	\$2,576,573	\$350,848
16 Rate Base (Reproduction Cost)	\$10,617,707	\$10,883,277	\$265,570
17 Rate Base (Fair Value)	\$6,421,716	\$6,729,925	\$308,209

18
19
20 There are four areas of disagreement between Staff and New River regarding rate base
21 which are discussed below.

22 **A. Inadequately Supported Plant.**

23 Staff proposes a deduction of \$222,346 to original cost rate base for utility plant that was
24 not supported by invoices.² Staff's deduction removes 100% of the inadequately supported plant.
25 In his Rebuttal Testimony, Mr. Jones recommended a less punitive approach:
26

27 ¹ The information in this table comes from the Issues Matrix Summary jointly submitted by New
28 River and Staff and admitted as Hearing Exhibit A-6.

² Hearing Exhibit S-1 (Brown Direct) at 12, lines 12-14.

1 The Company suggests that a more reasonable approach is to disallow a
2 percentage of the plant and has disallowed 10 percent of the plant balance,
3 totaling \$22,235 original cost and \$30,737 reconstruction cost. This amount is
4 substantial and, when coupled with Staff's recommendations that New River
5 submit a plan for training and implementation of new policies and procedures
6 related to record keeping and documentation retention, is sufficient to both protect
7 customers and punish New River.³

8 Mr. Jones further testified at the hearing that the problem with Staff's adjustment is that it
9 "goes too far" because it "doesn't recognize that the plant exists."⁴ "This imposes an excessive
10 financial burden on New River and creates a windfall for its customers."⁵ As an alternative, Mr.
11 Jones testified that it would be more appropriate to remove a percentage of the inadequately
12 supported plant.⁶ Thus, New River proposed a deduction of 10% of the amount of inadequately
13 supported plant.

14 In the last Johnson Utilities rate case in Docket WS-02987A-08-0180, Staff recommended
15 a 10% deduction for inadequately supported plant, as discussed in the Direct Testimony of Jeffrey
16 M. Michlik dated February 4, 2009:

17 Q. Is Staff recommending disallowance of all unsubstantiated plant?

18 A. No, rather than disallowing the entire plant cost, Staff decreased plant
19 costs by ten percent.

20 Q. How did Staff arrive at the ten percent disallowance?

21 A. Staff's typical range of disallowance for unsubstantiated plant ranges from
22 10 to 100 percent. Staff determined that only a minimal 10 percent
23 disallowance is warranted in this case.⁷

24 At the hearing, Staff witness Brown testified that when Staff recommends a disallowance
25 for inadequately supported plant, "[t]he range of disallowance has ranged from 10 percent in the
26 Johnson case to typically 50 percent or 100 percent."⁸ For the reasons discussed by Mr. Jones,
27 New River urges the ALJ to reject Staff's 100% disallowance of unsupported plant as too extreme
28 and instead adopt the Company's recommendation to disallow 10% of the unsupported plant.

³ Hearing Exhibit A-3 (Jones Rebuttal) at 5, lines 3-9.

⁴ Hearing Transcript Vol. I at 25, lines 5-6.

⁵ Hearing Exhibit A-4 (Jones Rejoinder) at 4, lines 26-27.

⁶ Hearing Transcript Vol. I at 25, lines 3-4.

⁷ Direct Testimony of Jeffrey M. Michlik dated February 4, 2009 (Docket WS-02987A-08-0180).

⁸ Hearing Transcript Vol. II at 321, lines 11-17.

1 **B. Accumulated Depreciation—Inadequately Supported Plant.**

2 While Staff and New River disagree regarding the amount of the deduction for
3 inadequately supported plant, they do not disagree on the methodology for computing the
4 accumulated depreciation expense associated with that adjustment. Mr. Jones testified at the
5 hearing that New River did not propose any adjustment to accumulated depreciation based upon
6 the Company's proposed disallowance for inadequately supported plant because the accumulation
7 adjustment was *di minimus*.⁹ However, he acknowledged that New River would have no
8 objection to the adjustment using Staff's methodology based upon the Company's proposed 10%
9 deduction of \$22,235 to plant.¹⁰

10 **C. Accumulated Depreciation—Depreciation Method.**

11 New River's pumping equipment account has a depreciation reserve imbalance resulting
12 from the over-accrual of depreciation expense because the depreciation rate recommended by
13 Staff and applied to the pumping equipment account in the Company's last rate case did not
14 match the actual expected lives of the Company's pumping plant.¹¹ The depreciation rate that
15 Staff recommended in New River's last case—and the rate it continues to recommend in this
16 case—is 12.5% per year.¹² At Staff's rate, the Company's pumping equipment is fully
17 depreciated in just eight years, which is much shorter than the average life of equipment typically
18 accounted for in the pumping equipment account.¹³ To address the problem, New River has
19 proposed a three-step approach which includes: (i) lowering the depreciation rate to 8.0% to be
20 more consistent with the underlying plant lives; (ii) resetting the depreciation base on which
21 annual depreciation is calculated by using the vintage group procedure for the pumping
22 equipment account; and (iii) addressing the historic over-depreciation by restating past recorded
23 accumulated depreciation for equipment added subsequent to New River's previous test year
24 expense at a depreciation rate of 5.0% based on a composite average service life of 20 years.¹⁴

25 _____
26 ⁹ Hearing Transcript Vol. I at 26, lines 12-17.

27 ¹⁰ Hearing Transcript Vol. I at 26, lines 17-19.

28 ¹¹ Hearing Exhibit A-3 (Jones Rebuttal) at 7, lines 10-12.

¹² Hearing Exhibit A-3 (Jones Rebuttal) at 7, lines 12-14.

¹³ Hearing Exhibit A-3 (Jones Rebuttal) at 7, lines 14-16.

¹⁴ Hearing Exhibit A-3 (Jones Rebuttal) at 10-12.

1 At the hearing, Mr. Jones explained the nature of the problem and the disagreement
2 between the parties regarding the depreciation rate for the pumping equipment account:

3 [W]hat has happened here is that because the rate applied was so great over a
4 relatively very short period of time, we've gotten into this really deep imbalance
5 between recorded depreciation and actual depletion of the facility. And so both
6 parties have decided that just adjusting the rate isn't really going to fix it. We've
7 got to go farther than that to fix it. And both parties have proposed various
8 restatements of past recorded depreciation. Mine is more extensive; Staff's is less
9 extensive. And both parties have suggested varying usage of the vintage year
10 group method on a going-forward basis to help prevent -- well, my proposal is
11 designed to help prevent further imbalance in the future. Staff's proposal doesn't
12 really go far enough. I don't think it accomplishes that. It leaves the opportunity
13 for another imbalance to be created. It almost certainly assures that another
14 imbalance will be created. It just won't be as bad as it would be if we did nothing
15 at all.

11 And the basic problem is that -- the basic disagreement is, Staff's testimony
12 blames the problem on using what is sort of generally referred to as the group
13 method, as opposed to the vintage group method. But that's a fundamental --
14 that's just wrong.

14 The problem is because the wrong rate has been used. It has nothing to do with
15 grouping. And that's the fundamental dispute between the parties.¹⁵

15 Mr. Jones' testimony is supported by the manual entitled Public Utility Depreciation
16 Practices (August 1996) published by the National Association of Regulatory Utility
17 Commissioners ("NARUC"), an excerpt of which was admitted as Hearing Exhibit A-21. The
18 NARUC manual, which is highlighted and annotated with Mr. Jones' comments, explains the
19 basic concepts of depreciation accounting:

20 Basically, depreciation accounting is the process of charging the book cost
21 (generally stated as original cost in utility accounting) of depreciable property,
22 adjusted for net salvage value, to operations over its useful life. The accounting
23 principle upon which depreciation is based is called the matching principle.
24 Under the matching principle, expenses are assigned to accounting periods in a
25 manner that matches expenses with revenues.

24 * * *

25 [T]he objective of computing depreciation is to allocate the cost or depreciation
26 base over the property's service life by charging a measure of the consumption of
27 plant taking place to each accounting period.

28 ¹⁵ Hearing Transcript Vol. I at 97-98.

1 Given the objective of allocating an asset's cost over its service life, it becomes
2 almost axiomatic that the life—either average service life, remaining life, or some
3 related measure—will enter into the computation of depreciation.

4 Common to all age-life methods is an estimate of service life and an
5 apportionment of expense to each year or accounting period so that the total cost
6 is recovered over the life of the asset.

7 Because reasonable estimates at any time are attainable, and age-life methods
8 directly meet the depreciation objective, age-life methods are favored by all
9 accounting, regulatory, and tax depreciation plans.¹⁶

10 The NARUC manual makes clear that the service life of the asset is the key to
11 depreciation accounting and not grouping. Because Staff does not use a depreciation rate that is
12 matched to the service life of the underlying plant, a mismatch is created and the accounting
13 objective is not attained.¹⁷ That is the essence of the problem with the pumping equipment
14 account.

15 At the hearing, Mr. Jones acknowledged that there has been confusion between the parties
16 regarding the use of the short-hand term “over-depreciation” with respect to the pumping
17 equipment account. Mr. Jones explained that when he uses the term over-depreciation, he is
18 describing the following problem:

19 What I am talking about is a depreciation reserve imbalance resulting from
20 overaccrual of depreciation expense. And that's using the language from this
21 [NARUC] manual. What it means is, in simple terms is the company has
22 recorded depreciation expense on its pumping plant far in excess of the actual
23 depletion of those facilities.

24 Another way to put it is, the facilities are virtually totally completely depreciated
25 for book purposes, although they have many, many, many years of useful life left.
26 And that is a significant mismatch between recorded expense and actual expense,
27 and that's the problem that I'm trying to address.¹⁸

28 When Staff uses the term “over-depreciation” it is referring to “the amount that an asset is
depreciated beyond its original cost.”¹⁹ Staff then contends, erroneously, that “[o]ver-
depreciation is not caused by improperly matched useful lives and depreciation rates as the

¹⁶ Hearing Exhibit A-21 at 43 and 51-52 (emphasis added).

¹⁷ See the Jones annotation on page 52 of Hearing Exhibit A-21.

¹⁸ Hearing Transcript Vol. I at 94, lines 13-25.

¹⁹ Hearing Exhibit S-2 (Brown Surrebuttal) at 13, line 4.

1 Company claims but by continuing to depreciate an asset after the original cost of the asset has
2 been fully recovered through depreciation expense.”²⁰ However, Mr. Jones correctly explains in
3 his Rejoinder Testimony that no individual asset can ever be “over-depreciated” as defined by
4 Staff when using a group depreciation procedure:

5 Q. WHEN USING GROUP DEPRECIATION PROCEDURE, CAN AN
6 INDIVIDUAL ASSET BECOME “OVER-DEPRECIATED” AS
7 DEFINED BY STAFF?

8 A. No. When calculating depreciation using a group procedure—be it the
9 broad group procedure currently used by New River or the vintage year
10 group procedure proposed by Staff—individual assets are not depreciated.
11 Rather, the group is depreciated using a composite depreciation rate based
12 on the composite average service life for the group. Therefore, because
13 individual assets are not separately depreciated, it is impossible for any
14 individual asset to be “over-depreciated” as Staff claims.

15 Q. DOES STAFF PROVIDE A VALID EXAMPLE OF ITS DEFINITION
16 OF “OVER-DEPRECIATION”?

17 A. No. In making its example, Staff selects a single asset from the group and
18 compares that asset’s life of 25 years to the 20-year composite life (5%
19 depreciation rate) of the group to arrive at Staff’s conclusion that the
20 specific asset is over-depreciated. Staff’s comparison of a single asset’s
21 life to the composite life of the group demonstrates a fundamental lack of
22 understanding of depreciation using a group procedure.

23 As stated in my rebuttal testimony, my analysis indicates that a
24 depreciation rate of 5.0% would have been appropriate for New River
25 based on a composite average service life of about 20 years for the pumps,
26 motors, electrical gear, piping, shut-off valves, automatic control valves,
27 meters, oiling systems, foundations and other appurtenances included in
28 the pumping equipment account. As discussed in my rebuttal testimony,
the individual assets in the pumping equipment account have significantly
varying useful lives.

Staff’s comparison of the life of any single asset to the composite life of
the group is a meaningless exercise that provides no support for Staff’s
definition of “over-depreciation.”

Q. ARE ANY OF NEW RIVER’S ASSETS “OVER-DEPRECIATED” AS
THE TERM IS USED BY STAFF?

²⁰ Hearing Exhibit S-2 (Brown Rebuttal) at 13, lines 5-7.

1 A. No. All of New River's plant account groups have accumulated
2 depreciation balances equal to or less than the original cost of the plant.
3 Since no plant account group is depreciated beyond its original cost, none
4 of New River's assets are "over-depreciated" as the term is defined by
5 Staff.²¹

6 Mr. Jones provided additional clarification at the hearing in response to questions from
7 staff counsel:

8 Q. Now, generally speaking, under the group method, depreciation expense
9 will be calculated on an asset as long as it is in service; is that correct?

10 A. I don't believe I agree with that. Under the group depreciation procedure,
11 the group is depreciated. Not individual assets. So I don't believe that's
12 correct.

13 Q. If you focused on the individual assets, would it become overdepreciated?

14 A. No, it would not, because the depreciation is based on the average service
15 life of the group and applied to the group. No individual asset is
16 separately depreciated.

17 Q. Doesn't that assume that the plant doesn't exceed the depreciation rate?

18 A. I don't understand that question. You'll have to rephrase that one for me.

19 Q. If an asset remains in service after it is fully depreciated, would the asset
20 then be depreciated beyond its original cost?

21 A. Not under the group, broad group procedure because only the group as a
22 whole is being depreciated. You are not depreciating individual assets.
23 That is the fundamental concept of the broad group procedure as opposed
24 to the single asset procedure that we looked at in the manual earlier.

25 Q. And the broad group procedure doesn't track individual assets; is that
26 correct?

27 A. That's correct.

28 Q. So you can't tell me for sure if an individual asset hasn't been
overdepreciated; is that correct?

A. No, that's not correct. I can tell you with certainty that no asset within the
broad group has been depreciated beyond its original cost because that is
simply impossible under proper application of the broad group
procedure.²²

²¹ Hearing Exhibit A-4 (Jones Rejoinder) at 7-8.

²² Hearing Transcript Vol. I at 136-137 (emphasis added).

1 In response to a question from the ALJ at the hearing, Mr. Jones explained further:

2 Q. Mr. Jones, if I understand what you're saying, it is that the individual asset
3 loses its individual identity altogether in terms of its own value and any
4 tracking of depreciation that would be related to that value as soon as it's
5 put in the broad group. Is that what you're saying?

6 A. Yes, that is correct. And that is why, regardless of the actual age of any
7 asset, under the NARUC procedure, when it is retired, whether it's one day
8 old and your brand new truck was totaled in an accident or whether your
9 truck that was on a five-year depreciation schedule actually lasted nine
10 years, the retirement is made as if that individual asset is exactly 100
11 percent fully depreciated. So that's exactly right. The asset loses its
12 identity when it's in the group and the group is depreciated; and the trade-
13 off for that is whenever an asset is retired, it is retired at exactly 100
14 percent fully depreciated.

15 Q. Okay.

16 A. That keeps the group in balance, and it keeps any individual asset from
17 being depreciated in excess of its original cost.²³

18 In contrast to Mr. Jones's testimony, Staff witness Brown bases the entirety of her
19 recommendations with regard to the depreciation of the pumping equipment account on the
20 erroneous contention that the group method of depreciation allows plant to be depreciated beyond
21 its original cost. Ms. Brown quotes from a publication entitled Accounting for Public Utilities
22 that was admitted as Hearing Exhibit S-10:

23 For group depreciation, an item reserve is not meaningful because the
24 depreciation rate applies to the total group, not any component part of the group,
25 and full recovery does not occur before retirement.²⁴

26 Ms. Brown then asserts that the "vintage year concept was established to correct this flaw."²⁵

27 However, these assertions are not supported by the evidence in this case and are flatly
28 contradicted by the plain language of the excerpt she quoted from Hearing Exhibit S-10.
Furthermore, her position fails to recognize that the vintage year procedure she advocates is a
group depreciation procedure, and if her criticisms of the broad group procedure were valid (they
are not), then those criticisms would apply equally to the vintage group procedure.

²³ Hearing Transcript Vol. I at 137-138.

²⁴ Hearing Transcript Vol. II at 282, quoting from Hearing Exhibit S-10.

²⁵ Hearing Transcript Vol. II at 283, lines 2-4.

1 The excerpt from Hearing Exhibit S-10 quoted above clearly contradicts Staff's position
2 and instead supports Mr. Jones' position that it is impossible for any individual asset within a
3 group—be it a broad group or a vintage year group—to be depreciated beyond its original cost.
4 Again, “[f]or group depreciation, an item reserve is not meaningful because the depreciation rate
5 applies to the total group, not any component part of the group, and full recovery does not occur
6 before retirement.”²⁶

7 As stated by Mr. Jones in his Rebuttal Testimony, “[b]ecause Staff's analysis is built on a
8 fundamentally flawed premise, Staff's discussion of the purported flaws of using the group
9 procedure should be rejected in its entirety.”²⁷ Likewise, all of Staff's related recommendations
10 regarding restatement of accumulated depreciation, use of the vintage year procedure, and
11 depreciation expense must be rejected. Instead, the ALJ should adopt Mr. Jones' recommended
12 three-step approach to fixing the problem which includes: (i) lowering the depreciation rate to
13 8.0% to be more consistent with the underlying plant lives; (ii) resetting the depreciation base on
14 which annual depreciation is calculated by using the vintage group procedure only for the
15 pumping equipment account; and (iii) addressing the historic over-depreciation by restating past
16 recorded accumulated depreciation for equipment added subsequent to New River's previous test
17 year at a depreciation rate of 5.0% based on a composite average service life of 20 years.

18 **D. Working Capital.**

19 New River proposed a cash working capital allowance of \$95,338 based upon the formula
20 method. The Company requests that the ALJ approve its request for cash working capital.

21 **III. EXPENSE ISSUES.**

22 Each of the disputed expense items are discussed below.

23 **A. Salaries and Wages.**

24 Staff witness Crystal Brown makes the following recommendations regarding New
25 River's record-keeping in her Direct Testimony:

26 ²⁶ Hearing Exhibit S-10 at 6-17 and 6-18.

27 ²⁷ Hearing Exhibit A-3 (Jones Rebuttal) at 9, lines 25-27.

1 Staff recommends that the Company be ordered to file with Docket Control a
2 plan, subject to Staff approval, describing the actions it will take to maintain its
3 books and records in compliance with Arizona Administrative Code R14-2-
4 610.D.1 and the NARUC USoA within 60 days of the date of the decision
5 resulting from this proceeding. The plan should include, but not be limited to:

- 6 1. Training on the record keeping requirements of Arizona Administrative
7 Code R14-2-610.D.1.
- 8 2. Implementation of policies and procedures to help ensure that source
9 documentation such as invoices and canceled checks are maintained to
10 support plant costs and are not destroyed or thrown away.
- 11 3. Training on recording AIAC's in accordance with the NARUC USoA.

12 * * *

13 Staff recommends that the Company use work orders to help record retirements.
14 Staff further recommends that retirement work order should include the following
15 information: (a) whether the retirement cost utilized is actual or estimated; (b) the
16 name of the water company or system from which the plant was removed; (c) the
17 date of the retirement; (d) the NARUC account number from which the plant was
18 removed; (e) the reason for the retirement; and (f) appropriate approvals on the
19 work orders.²⁸

20 In order to comply with these Staff recommendations, New River made an adjustment to
21 increase payroll costs by \$48,600 (\$45,000 increase to Salaries and Wages and a corresponding
22 increase of \$3,600 to Taxes Other than Income) to include an accounting analyst on the
23 Company's staff.²⁹ At the hearing, Mr. Jones testified that the current employee staffing of New
24 River is "very lean," adding that "I think it's very difficult to run an almost 3,000 customer utility
25 with a total of five people."³⁰

26 In his Rebuttal Testimony, Mr. Jones testified as follows:

27 Throughout this rate case process, I have been working with New River's
28 management and outside accounting firm to address the issues that Staff is
concerned about. Much progress has been made. However, once the rate case is
concluded, New River will need dedicated staff to track and address accounting
issues on a daily basis. I have recommended that New River hire an Accounting
Analyst to fulfill this role.³¹

²⁸ Hearing Exhibit S-1 (Brown Direct) at 49-50.

²⁹ Hearing Exhibit A-3 (Jones Rebuttal) at 20, lines 10-28.

³⁰ Hearing Transcript Vol. I at 171-172.

³¹ Hearing Exhibit A-3 (Jones Rebuttal) at 20, lines 22-28.

1 There is no evidence in the record to contradict Mr. Jones' recommendation of the need
2 for an accounting analyst to address the accounting issues raised by Staff. The Company's
3 request is reasonable and the expense associated with a new employee for a very lean company
4 should be approved.

5 **B. Inadequate Credit Card Support (Repairs and Maintenance).**

6 New River submitted credit card statements for a personal credit card in the name of
7 Robert Fletcher which contained \$27,584 in test-year charges for repair and maintenance items.
8 In reviewing the credit card statements submitted by the Company, Ms. Brown stated in her
9 Direct Testimony that "approximately 75% of each bill was completely blacked out" and that
10 Staff assumed "that the redacted charges were personal expenses of the owner and the unredacted
11 charges were the repairs and maintenance charges proposed for New River."³² Ms. Brown further
12 stated that of the \$27,584 in test-year repairs and maintenance charges proposed for New River,
13 Staff "disallowed transactions that were not needed in the provision of service ... [and]
14 ...disallowed transactions wherein the location of the transaction was partially or completely
15 redacted."³³ What was left were "transactions made in the Phoenix metro area, that were not
16 partially redacted and were for Home Depot; Lowe's; various hardware stores; AOL Service;
17 Wagner Equipment; Arizona Lawn King; Harbor Freight; Dunn-Edwards; USPS; and such other
18 stores."³⁴ The amount of such charges totaled \$9,328 as set forth on line 37 of Schedule CSB-25
19 to Ms. Brown's Direct Testimony. New River did not dispute this adjustment.³⁵

20 However, after reducing the Company's repair and maintenance expenses from \$27,584
21 to \$9,328, Staff proposed an additional 66% reduction by allocating one-third of the credit card
22 charges to Mr. Fletcher personally and one-third to affiliate Cody Farms.³⁶ There is simply no
23 evidence in the record that the \$6,219 in credit card charges Staff allocated to Mr. Fletcher and
24 Cody Farms are for anything other than repairs and maintenance expense for New River. Ms.
25 Brown acknowledges in her Direct Testimony that Staff already "disallowed transactions that

26 ³² Hearing Exhibit S-2 (Brown Direct) at 34, lines 18-25.

27 ³³ Hearing Exhibit S-2 (Brown Direct) at 35, lines 5-17.

28 ³⁴ Hearing Exhibit S-2 (Brown Direct) at 35, lines 19-23.

³⁵ Hearing Exhibit A-3 (Jones Rebuttal) at 18, lines 7-9.

³⁶ Hearing Exhibit S-2 (Brown Direct) at 36, lines 5-12.

1 were not needed in the provision of service.”³⁷ Furthermore, Ms. Brown acknowledged on cross-
2 examination that “even if there was something on that bill that [Staff] thought could reasonably
3 have been a candidate for a repair or maintenance expense, if the location of that charge on the
4 credit card, meaning the place where the item was purchased, was either completely obscured or
5 partially obscured, [Staff] didn’t include those either.”³⁸ Staff’s allocation of two-thirds of the
6 \$9,328 in credit card charges to Mr. Fletcher personally and to Cody Farms is excessive, arbitrary
7 and unnecessarily punitive. New River requests that the ALJ allow the full adjusted amount of
8 \$9,328 in repairs and maintenance expense.

9 **C. Tank Painting (Repairs and Maintenance).**

10 New River is seeking \$31,333 in repair and maintenance expense for the normalized costs
11 of needed water storage tank recoating. In his Direct Testimony, Mr. Jones explained how he
12 determined the normalized expense amount:

13 Tank recoating costs were normalized based on a 15-year schedule of tank
14 recoating covering all of New River’s steel storage tanks. The schedule is based
15 on a target date of 15 years from the last tank coating with minor schedule
16 adjustments to smooth cash flow. New River’s recovery of tank recoating costs is
17 critical as many of New River’s tanks are at or approaching the age that they
18 require their first recoating.³⁹

19 In his Rebuttal Testimony, Mr. Jones added the following:

20 [T]he Company has diligently moved forward with its tank recoating plan. On
21 May 2nd of this year the Company obtained the proposal attached hereto as Exhibit
22 RLJ-RB-2 [Hearing Exhibit A-20] from Arizona Coating Applicators for
23 recoating the storage tank at the Company’s 78th Lane Booster Plant. New River
24 has accepted the recoating proposal and committed to an expenditure of \$130,000
25 to be completed this fall, once temperatures allow the contractor to safely work
26 inside the tank.⁴⁰

27 However, Staff has removed the \$31,333 tank recoating adjustment, arguing initially in
28 the Direct Testimony of Ms. Brown that New River would have the money to pay for tank
recoating if the Company’s owner had repaid an intercompany balance⁴¹ between New River and

³⁷ Hearing Exhibit S-2 (Brown Direct) at 35, line 6.

³⁸ Hearing Transcript Vol. II at 325, lines 12-18.

³⁹ Hearing Exhibit A-1 (Application and Direct Testimony of Ray Jones) at 12, lines 16-21.

⁴⁰ Hearing Exhibit A-3 (Jones Rebuttal) at 19, lines 6-12.

⁴¹ Staff has attempted to characterize the intercompany balance as a loan from New River to Cody Farms. However, the Company has strongly disagreed with Staff’s characterization of the

1 affiliate Cody Farms.⁴² The problem with Staff's argument is that it completely sidesteps the fact
2 that tank recoating is a legitimate and known expense of the Company that should be paid out of
3 rates. Mr. Jones correctly noted in his Rebuttal Testimony that "Staff's adjustment is nothing
4 more than an attempt to force an affiliate of New River to fund tank painting rather than New
5 River's customers."⁴³

6 In her Surrebuttal Testimony, Ms. Brown responded that it is not the responsibility of
7 customers to provide the cash necessary for tank painting prior to the tanks actually being
8 painted.⁴⁴ However, that is not a fair characterization of New River's proposed expense
9 allowance. Mr. Jones testified that New River has accepted a proposal from Arizona Coating
10 Applicators and committed to spend \$130,000 to recoat the 78th Lane Booster Station this fall,
11 once temperatures allow the contractor to safely work inside the tank. Moreover, in his Rejoinder
12 Testimony, Mr. Jones explained as follows:

13 [T]he Company's anticipated tank coating expenses are all incurred within the
14 next six years, with recovery occurring over a 15-year normalization period. This
15 heavily front-loaded schedule results in the Company expending \$313,335 more
16 for tank painting in the first six years than is recovered in those same six years.
The Company is not made whole for these tank painting expenses until 2027.⁴⁵

17 Clearly, New River's customers will not be providing cash for tank recoating prior to the tanks
18 being recoated.

19 Ms. Brown next argues that "cash flow is sufficient to fund the Company's projected
20 \$31,333 in annual tank painting costs" without the adjustment.⁴⁶ However, the failure to allow
21 normalized tank painting expense ensures that New River cannot earn its authorized rate of
22 return. Thus, the failure to include tank painting expense will result in rates that are not just and
23 reasonable.

24
25 _____
intercompany balance as a loan.

26 ⁴² Hearing Exhibit S-1 (Brown Direct) at 36-37.

27 ⁴³ Hearing Exhibit A-3 (Jones Rebuttal) at 18-19.

28 ⁴⁴ Hearing Exhibit S-2 (Brown Surrebuttal) at 21, lines 16-18.

⁴⁵ Hearing Exhibit A-4 (Jones Rejoinder Testimony) at 10-11.

⁴⁶ Hearing Exhibit S-2 (Brown Surrebuttal) at 21, lines 22-25.

1 Ms. Brown testified at the hearing that “there is the NARUC recognized principle of
2 historical cost’ and also that “[t]he amount was not known and measurable.”⁴⁷ However, both of
3 these arguments supporting Staff’s adjustment should be rejected. This Commission allows pro
4 forma adjustments to historical test year expenses when those adjustments are known and
5 measurable. For example, in rate case Docket No. W-01303A-10-0448, Arizona-American Water
6 Company requested and sought approval of a new tank maintenance program for its Agua Fria
7 Division—a program very similar to that proposed by New River in this case. The Arizona-
8 American tank maintenance program was described in the Direct Testimony of Ian Crooks, a
9 copy of which is attached hereto for convenience as Attachment 1, as follows:

10 The tank maintenance plan for Agua Fria is based on a 15-year schedule for
11 recommended repairs and painting. The industry standard for tank maintenance
12 ranges from 10-15 years depending on tank material and exposure to
13 environmental conditions (water, weather, soil). We chose 15 years for several
14 reasons: 1) the oldest tank in Agua Fria, WP 2 Tank 1, will be 15 years old in
15 2011 and each year after the next scheduled tank approaches the 15 +/- years old,
16 2) Agua Fria has sixteen tanks which allows the Company to perform
17 maintenance on one tank per year, with the expectation of one year which
18 includes two tanks because one tank is small at 100,000 gallons, 3) the TIC report
19 on WP2 Tank 1 concludes the tank’s interior is in fair to poor condition with
20 widespread corrosion and blistering that should be repaired within the next three
21 years, which supports that 15 years is the appropriate maintenance cycle for the
22 tanks in the Agua Fria District under the given environmental conditions, 4) the
23 subsequent tanks are expected to be in similar condition in 15 years because the
24 environmental conditions are relatively similar among all Agua Fria District
25 tanks, and 5) the schedule will lessen the impact to both the customer and the
26 Company by keeping maintenance expenses to one tank a year. Please refer to
27 Exhibit ICC-1 for detailed schedule and estimated costs.

28 The estimated yearly maintenance expense annualized over the 15-year cycle is
estimated to be \$376,478, as recommended as an annual revenue stream in the
testimony of Company witness Ms. Linda J. Gutowski. It is anticipated that this
estimated expense would be available for review and adjustment when necessary
in subsequent Agua Fria Water District cases.⁴⁸

⁴⁷ Hearing Transcript Vol. II at 293, lines 9-11.

⁴⁸ Direct Testimony of Ian Crooks, P.E., on Behalf of Arizona-American Water Company dated
November 3, 2010 (Docket No. W-01303A-10-0448 (emphasis added)).

1 The evidence in this case regarding the need for tank recoating and the reasonableness of
2 the proposed normalize expense is unrefuted. At the hearing, Ms. Brown responded to the
3 following questions on cross examination:

4 Q. You don't have any argument with the company's statement that these
5 water storage tanks need to be painted approximately every 15 years?

6 A. No.

7 Q. And you wouldn't deny that the company over the next several years will
8 need to be spending money to recoat or repaint these storage tanks?

9 A. No.

10 Q. And you have seen Mr. Jones' projection of a cost of approximately
11 \$470,000 to repaint these tanks?

12 A. Yes.

13 Q. And you're aware that Mr. Jones is an engineer and former president of a
14 water utility company?

15 A. Yes.⁴⁹

16 In addition, Staff engineering witness Del Smith provided testimony corroborating the
17 reasonableness of the Company's proposed tank recoating expenses. Hearing Exhibit A-20 is a
18 copy of a proposal from Arizona Coating Applicators which was attached as Exhibit RLJ-RB-2 to
19 Mr. Jones' Rebuttal Testimony. Regarding Hearing Exhibit A-20, Mr. Scott responded to
20 questions from the ALJ regarding the reasonableness of the tank-recoating costs:

21 Q. Do you have an opinion regarding the reasonableness of the costs?

22 A. I don't have any reason to, you know, not to find this acceptable. It's been
23 some time since I've seen a quote for tank painting, but I understand that
24 this -- I assume this is one of the -- I think there were three 1,000,000
25 gallon tanks, and this apparently is for one tank, or at least that's the way
I'm reading it. And so for a million gallon tank, that's a pretty large tank,
so it sounds to be within the ballpark.

26 Q. So it's within what you would consider to be the fair market cost for that
27 type of work?

28 ⁴⁹ Hearing Transcript Vol. II at 329-330.

1 A. Well, the amount of work, prep work and stuff that has to be done, and it
2 looks like they pretty much got all the bases covered here. It's been a long
3 time since I've looked at a proposal like this, but it, you know, it's
believable.⁵⁰

4 In his Rejoinder Testimony, Mr. Jones succinctly and accurately summarized the evidence
5 regarding the tank recoating issue:

6 Staff does not dispute the Company's tank recoating schedule or projected costs.
7 The Company is diligently moving forward with its tank recoating plan and will
8 incur substantial costs well in advance of cost recovery. The Company's request
9 to recover its normalized tank painting costs is reasonable and consistent with
similar requests routinely approved by the Commission. The Company's
adjustment for normalized tank painting expenses should be accepted and Staff's
proposed elimination of these expenses from the cost of service rejected.⁵¹

10 The Commission allowed tank recoating expense for future tank recoating projects for
11 Arizona-American Water Company's Agua Fria Division in Decision 73145 (Docket W-01303A-
12 10-0448). For all of the reasons set forth above, there is no reasonable basis for rejecting the
13 Company's request for normalized tank-recoating expense in the amount of \$31,333 in this case.

14 **D. Workshop Rent (Rent-Buildings).**

15 Substituting its judgment for that of New River management, Staff arbitrarily reduces
16 annual rent expense for workshop rent by \$9,000 (from \$12,000 to \$3,000) on the claimed basis
17 that the Company needs only 1,000 square feet of workshop space and not the 4,000 square feet
18 the Company currently rents from Cody Farms. Staff's adjustment should be rejected for at least
19 four reasons. First, the evidence shows that New River actually needs and uses 4,000 square feet
20 of workshop space. Second, Staff arbitrarily assumes without any evidentiary support that the
21 Company could rent 1,000 square feet of space at the same rate per square foot that it rents 4,000
22 square feet of space. Third, Staff assigns no value to the use of several pieces of equipment that
23 are necessary and useful in the operation of the water utility. Fourth, it is simply unreasonable to
24 expect that New River could find suitable workshop rent with access to essential equipment at a
25 rental rate of only \$250 per month.

26
27
28 ⁵⁰ Hearing Transcript Vol. I at 192, lines 9-25.

⁵¹ Hearing Exhibit A-4 (Jones Rejoinder) at 11, lines 5-11.

1 In her Surrebuttal Testimony, Staff witness Brown states that “Staff found that New
2 River’s materials and supplies were housed in a small area (about 10’ x 10’) within a 1,000
3 square foot room located within the 12,000 square foot storage facility.”⁵² She continues that
4 “Staff determined that 1,000 square feet was more than enough space to store all of New River’s
5 materials and equipment that needed to be stored indoors.”⁵³ However, Mr. Jones testified that
6 New River uses the workshop space for much more than simply storing materials and supplies.
7 In his Rebuttal Testimony, Mr. Jones testifies that the Company uses the workshop to “work on
8 vehicles and equipment” in addition to storing materials and supplies.⁵⁴ Mr. Jones gave the
9 following example:

10 [I]f you were bringing some heavy piece of pipe or something in, you could
11 actually drive a truck in here with a trailer, if necessary, back it up to the welding
12 area so you could work on it if you needed to.⁵⁵

13 Ms. Brown’s adjustment to rent does not give appropriate consideration to the need for
14 workshop space to work on vehicles and equipment.

15 Furthermore, Mr. Jones testified that the workshop space gives New River access to a
16 “drill press and a grinder and some other large tools that are available to New River and are
17 occasionally used.”⁵⁶ Mr. Jones testified that these pieces of equipment are located in the larger
18 portion of the storage facility (*i.e.*, outside the 1,000 square-foot room discussed by Ms. Brown in
19 her testimony).⁵⁷ Mr. Jones testified that New River has access to “an electric arc welder and an
20 oxyacetylene cutting torch,” which are “things that New River would use from time to time.”⁵⁸
21 Mr. Jones testified that these pieces of equipment would be used for such tasks as removing
22 frozen bolts from equipment, brazing copper pipe fittings together, cutting metal, and building
23 brackets and stands.⁵⁹ Mr. Jones testified that an arc welder and oxyacetylene cutting torch would

24 _____
25 ⁵² Hearing Exhibit S-2 (Brown Surrebuttal) at 24, lines 1-3.

26 ⁵³ Hearing Exhibit S-2 (Brown Surrebuttal) at 24, lines 6-7.

27 ⁵⁴ Hearing Exhibit A-3 (Jones Rebuttal) at 21, lines 6-7.

28 ⁵⁵ Hearing Transcript Vol. I at 91, lines 4-8.

⁵⁶ Hearing Transcript Vol. I at 86, lines 12-15 (referring to picture no. 7 in Hearing Exhibit A-19).

⁵⁷ Hearing Transcript Vol. I at 86, lines 16-18.

⁵⁸ Hearing Transcript Vol. I at 87, lines 10-13 (referring to picture no. 8 in Hearing Exhibit A-19).

⁵⁹ Hearing Transcript Vol. I at 87-88.

1 need to be used “in a ventilated space or a sufficiently open space to prevent harmful gases from
2 collecting.”⁶⁰

3 Mr. Jones further testified that the workshop provides New River with access to sand-
4 blasting equipment.⁶¹ Sandblasting equipment is used to refurbish water meters.⁶² Mr. Jones
5 testified that “[s]andblasters are very dirty pieces of equipment to use” and that sandblasting
6 requires a large workspace.⁶³

7 Mr. Jones further testified that New River stores fire hydrant meters, water meters, pipe
8 and fittings, and equipment in the larger portion of the workshop facility.⁶⁴ Mr. Jones testified
9 that the workshop provides New River with access to rest rooms, which are located outside of the
10 1,000 square-foot room discussed by Ms. Brown in her testimony.⁶⁵

11 Staff allows only \$250 per month rent for workshop space. In making her adjustment to
12 workshop rent, Ms. Brown fails to assign any value to the use of the drill press, grinder, electric
13 arc welder, oxyacetylene cutting torch, sandblasting equipment, and other pieces of equipment in
14 the workshop, nor does she assign a value to the use of the rest rooms or the larger portion of the
15 workshop space for repairing equipment. It is simply unreasonable to expect that New River
16 could rent workshop space with access to all of the equipment mentioned above at a monthly
17 rental rate of \$250, which is likely less than the monthly payment on a typical car loan.

18 In making her adjustment, Ms. Brown provides no evidence that New River could rent
19 1,000 square feet of space at the very same rate that it rents \$4,000 square feet of space. At the
20 hearing, Ms. Brown acknowledged that Staff did not perform a market analysis to determine what
21 a fair market rent for the workshop space would be.⁶⁶ Mr. Jones aptly summarizes the defects in
22 Staff’s adjustment:

23
24

⁶⁰ Hearing Transcript Vol. I at 88, lines 6-10.

25 ⁶¹ Hearing Transcript Vol. I at 88, lines 11-12 (referring to picture no. 9 in Hearing Exhibit A-19).

26 ⁶² Hearing Transcript Vol. I at 88, lines 15-21.

27 ⁶³ Hearing Transcript Vol. I at 88-89.

28 ⁶⁴ Hearing Transcript Vol. I at 89-90 (referring to pictures nos. 10-11 in Hearing Exhibit A-10).

⁶⁵ Hearing Transcript Vol. I at 91, lines 14-25 (referring to pictures nos. 14-15 of Hearing Exhibit A-19).

⁶⁶ Hearing Transcript Vol. II at 337-338.

1 This adjustment should be rejected. It does not address the only pertinent
2 question, "Is rental of a 4,000 square-foot facility at an annual cost of \$3.00 per
3 square foot reasonable and prudent?" The answer is an unequivocal yes. This is a
4 very cheap price for a reasonable amount of workshop space. Instead of
5 accepting this reasonable arrangement and cost, Staff takes New River's very
6 good arrangement and turns it into an even better, albeit fictional, deal for 1,000
7 square feet of space at \$3.00 per square foot.⁶⁷

8 New River's rental of 4,000 square feet of workshop space at an annual cost of \$3 per
9 square foot is a reasonable and prudent expense that should be included in the Company's
10 revenue requirement. Staff's adjustment simply substitutes Staff's judgment for the business
11 judgment of the Company. New River requests that the ALJ allow the full \$12,000 of annual
12 workshop rent in the cost of service.

13 **E. Office and Booster Station Property Rent (Rent-Buildings).**

14 New River pays \$48,600 annually to rent an approximately 2,200 square-foot business
15 office and the 87th Avenue Booster Plant property, including a well on that property.⁶⁸ However,
16 Staff has denied all rent expense for the 87th Avenue Booster Plant property and allows only
17 \$23,580 in rent expense for the business office.⁶⁹ As set forth in the Rebuttal Testimony of Mr.
18 Jones, "Staff's adjustment allows only about \$10.72 per year per square foot for the 2,200 square
19 foot business office [$\$23,580 / 2,200 = \10.72], while allowing nothing for the booster station
20 property."⁷⁰ Mr. Jones testified further:

21 The Company's management has inquired as to the leasing costs of the
22 commercial property immediately east of New River's office and has been
23 advised that the cost is \$17.50 per square foot per year. Using the cost of this
24 immediately adjacent commercial property, the annual rental value of the business
25 office is \$38,500 (2,200 x \$17.50). This leaves only \$10,100 annually for the
26 rental cost of the booster station property. These are reasonable costs and should
27 be included in the Company's expenses.⁷¹

28 According to Staff witness Brown, Staff used the real estate database Zillow.com to
obtain estimates of the sale price and rental price for the New River business office.⁷² Ms. Brown

⁶⁷ Hearing Exhibit A-3 (Jones Rebuttal) at 21, lines 11-17.

⁶⁸ Hearing Exhibit A-3 (Jones Rebuttal) at 21, lines 18-20

⁶⁹ Hearing Exhibit S-1 (Brown Direct) at 42-43.

⁷⁰ Hearing Exhibit A-3 (Jones Rebuttal) at 21, lines 20-22.

⁷¹ Hearing Exhibit A-3 (Jones Rebuttal) at 21, lines 22-28.

⁷² Hearing Exhibit S-1 (Brown Direct) at 43, lines 9-10.

1 testified in her Direct Testimony that Zillow.com provided a monthly rental price of \$1,950 for
2 the Company's business office located at 7939 W. Deer Valley Road.⁷³ Ms. Brown testified at
3 the hearing that she compared the rent amount provided by Zillow.com to "a Commission office
4 located near downtown Phoenix and a water utility office located near downtown Tucson."⁷⁴
5 However, Ms. Brown did not provide any information such as the address, square footage or
6 price-per-square-foot for either of these two buildings in her Direct Testimony or Surrebuttal
7 Testimony, nor was she able to provide such information at the hearing.⁷⁵

8 Ms. Brown also testified at the hearing that she did not know whether the New River
9 business office is zoned commercial or residential.⁷⁶ Later, however, she testified that the New
10 River business office is located in an area that Staff believes is zoned commercial, as evidenced
11 by the following exchange between counsel for New River and Ms. Brown:

12 Q. ... Does that indicate to you that Zillow does not appraise or does not
13 provide estimates on commercial properties?

14 A. Yes. And Staff compared the amounts that it had recommended to the
15 Pipeline Safety Office, which is similar to commercial property, and to the
16 Ray Water Utility Company and compared to those it's reasonable.

17 And also, the house that was converted into [the New River] business
18 office is not located in an area that Staff believes is zoned commercial,
19 because it's right smack dab in the middle of a residential neighborhood.⁷⁷

20 On September 30, 2013, New River filed the Affidavit of Ray L. Jones in Support of
21 Late-Filed Exhibits. In his affidavit, Mr. Jones confirmed the zoning designation of the New
22 River business office as commercial in paragraphs 6, 7, 8 and 11, stating as follows:

23 6. Attached hereto as Attachment 1 is a City of Peoria Zoning Map, Sheet
24 No. 5-A ("Zoning Map 5-A"), which I printed from the City of Peoria's web site.
25 On Zoning Map 5-A, I have highlighted with a rectangular red box the area
26 including the New River business office, the shop that New River rents from
27 Cody Farms, Inc., and the New River booster station.

28 ⁷³ Hearing Exhibit S-1 (Brown Direct) at 43, lines 10-11.

⁷⁴ Hearing Transcript Vol. II at 342, lines 15-18.

⁷⁵ Hearing Transcript Vol. II at 342-344.

⁷⁶ Hearing Transcript Vol. II at 347-348.

⁷⁷ Hearing Transcript Vol. II at 350, lines 2-12.

1 7. Attached hereto as Attachment 2 is an exhibit I prepared, identified as
2 Figure 1, which is an enlargement of the area highlighted on Zoning Map 5-A.
3 On Figure 1, I have highlighted with red arrows the New River business office,
4 the rented shop and the booster station.

5 8. Figure 1 shows that the New River business office is located on a
6 commercially designated parcel within a PAD or "Planned Area Development"
7 zoning district, per the approved PAD Z02-27A.4. More specifically, as PAD-
8 zoned property the uses must conform to what is contained in the Standards and
9 Guidelines Report submitted with the PAD application. In the case of the New
10 River business office, the designated use per the submitted and approved
11 Standards and Guidelines Report is any commercial use that conforms to the O-1
12 Office Commercial zoning district.

13 11. The rented shop and booster station are in the PI-1 or "Planned Light
14 Industrial" zoning district. Peoria's zoning ordinance describes the PI-1 zoning
15 district as follows:

16 The PI-1 District is intended to accommodate certain industrial
17 structures and uses having physical and operational characteristics
18 that might have potential adverse impacts on adjacent properties.
19 The regulations and development standards are designed to permit
20 those industrial uses which can be operated in a relatively clean,
21 quiet and safe manner, and are compatible with adjoining industrial
22 uses without causing adverse impacts, danger or hazard to nearby
23 non-industrial uses.⁷⁸

24 In reducing the office rent for the New River business office, Staff consulted the website
25 Zillow.com, a computer data base which provides what is calls "Zestimates" for residential real
26 estate, and then compared a "Rent Zestimate" for the business office to rental rates for a
27 downtown office used by the Commission and a business office used by a water utility in Tucson.
28 Staff's methodology should be rejected because it is fatally flawed and incapable of producing an
accurate or fair rental value of the New River business office. Zillow.com does not purport to
provide rental rates or valuations for commercial properties and it is certainly no substitute for a
real estate appraisal. Moreover, the buildings that Staff used in an attempt to corroborate the
Zillow.com number are not located anywhere near the New River business office, and there is
virtually no evidence in the Staff testimony or the record providing any details on the buildings.

⁷⁸ Affidavit of Ray L. Jones in Support of Late-Filed Exhibits dated September 30, 2013, at 1-3
(emphasis added). New River filed corrected versions of the zoning maps attached as
Attachments 1 and 2 to the Jones affidavit on October 1, 2013 in a Notice of Errata.

1 Staff's proposed rental expense for the New River Business office is not credible based
2 upon the evidence and Staff provides no rental expense for the 87th Avenue Booster Plant
3 property, which without any dispute, is used to provide service to the customers of New River.
4 Mr. Jones has testified that New River obtained a cost of \$17.50 per square foot per year on a
5 commercial property immediately east of the Company's business office.⁷⁹ Using the cost of this
6 immediately adjacent commercial property, the annual rental value of the business office is
7 \$38,500. The annual rental expense of \$48,600 which New River pays to rent the business office
8 and the 87th Avenue Booster Plant property, including a well on that property, is reasonable and
9 should be adopted.

10 **F. Removing the Rent Expense for One Work Truck (Rent-Vehicles).**

11 In removing the rental expense for one of the four vehicles used by New River, Staff has
12 again substituted its business judgment for that of Company management. In Schedule CSB-33,
13 Staff removes \$400 per month of rental expense for the Chevrolet Silverado pickup truck that is
14 used by Karen Fletcher, the Office Manager, Secretary and Treasurer of New River.⁸⁰ However,
15 Staff provides no supportable evidence that the amount of the rent is unreasonable or that the
16 vehicle is not used by Ms. Fletcher in the performance of her duties for the Company.

17 In response to Staff Data Request 1.20, a copy of which was admitted as Hearing Exhibit
18 A-12, New River listed the job duties of Ms. Fletcher, which include the following:

- 19
- 20 • Insure that all procedures and computer updates are completed in a timely and accurate basis
 - 21 • Approve software and hardware upgrades as to cost effectiveness and usability
 - 22 • Interface with contract IT personnel to promote efficiencies and accuracies
 - 23 • Take deposits to the bank
 - 24 • Take the monthly billing and past due billing to the post office, as needed
 - 25 • Handle customer complaints requiring management resolution
- 26

27 ⁷⁹ Hearing Exhibit A-3 (Jones Rebuttal) at 21, lines 22-24.

28 ⁸⁰ Hearing Exhibit S-1 (Brown Direct), Schedule CSB-33; Hearing Exhibit A-12.

- 1 • Maintain office supplies and reorder as necessary

2 At the hearing, Mr. Jones elaborated upon Ms. Fletcher's duties and upon the importance
3 of her having a company vehicle:

4 Q. [O]ne of Ms. Fletcher's responsibilities is to ensure that all procedures and
5 computer updates are completed in a timely and accurate basis.

6 I believe you've testified that the company has been working with their
7 computer vendors to update software and things of that nature; is that
8 right?

8 A. Yes. They've recently, as I said, added the QuickBooks program and
9 brought that in as a new project. They work virtually almost on a day-to-
10 day basis with their billing system vendor to keep that up-to-date and to
11 keep that system properly upgraded and effectively used for the company.

11 Q. And as the office manager, would you expect that Ms. Fletcher would be
12 attending meetings out of the office in order to coordinate with software
13 vendors and to do the kind of things that needed to happen to make sure
14 that those upgrades occurred?

14 A. That could certainly occur from time to time, absolutely. Meet with the
15 accounting, outside accounting staff. For instance, if you're looking at
16 QuickBooks software, I would think that she might want to have a
17 meeting with the staff over there and make sure that it interfaces with the
18 accountant's system and issues like that, absolutely.

17 Q. And in that same bullet point, the third sentence says, "Interface with
18 contract IT personnel to promote efficiencies and accuracies." Again,
19 would it be your expectation that an interfacing with contract IT
20 personnel, that that might involve trips to meetings and time away from
21 the office?

21 A. It could. I would actually think that function would occur more the other
22 way around with the IT people coming to the office, but certainly what
23 you've asked isn't out of the question.

22 Q. Then if you would drop down two bullet points, there's a description,
23 "Take deposits to the bank as needed." Would that be a regular ongoing
24 occurrence for an office manager?

24 A. Certainly. Most companies would make deposits daily.

25 Q. And you would need a vehicle to do that?

26 A. Yes, absolutely.

1 Q. And below that, "Take the monthly billing and past due billing to the Post
2 Office as needed." Again, would that job duty require the use of a
3 vehicle?

4 A. It would.

5 Q. And would that be at least a several-times-a-month type activity?

6 A. Yes, a few times a month.

7 Q. And the bullet point below that, "Handle customer complaints requiring
8 management resolution." Would it be reasonable to assume that to fulfill
9 that function, that Ms. Fletcher would need to get in her vehicle and go see
10 a customer?

11 A. Absolutely. Most customer interactions are handled at the office because
12 typically people would come to the office. But it certainly is not unusual
13 in serious matters or where there's a larger issue that a manager wouldn't
14 go visit a customer at their home to discuss it.

15 Q. And if you would turn to the following page, the bullet item that's sixth
16 from the top says, "Maintain office supplies." Again, I think you testified
17 earlier that that might involve trips to Office Depot or other places in
18 keeping the office properly stocked?

19 A. Yes, of course.⁸¹

20 Additionally, Mr. Jones testified regarding the importance of having redundancy in a
21 utility's fleet of vehicles, especially in the case of a small utility:

22 Q. When you have a company with four vehicles, and as you've testified, one
23 where the staff may be spread kind of thin, would you comment on the
24 importance of having some redundancy in your vehicle fleet?

25 A. Well, it's very important, and much more important than it would be in a
26 larger company. If you look at it sort of the opposite way and assume they
27 only had three vehicles, if they have a breakdown with any one vehicle,
28 they've lost a third of their fleet capability. That's pretty significant. With
four vehicles, you've reduced that third down to a quarter. Still
significant, but less.⁸²

The use of four company vehicles for a company the size of New River is reasonable and
the Company's rent expense should not be reduced by one vehicle.

⁸¹ Hearing Transcript Vol. I at 173-176.

⁸² Hearing Transcript Vol. I at 176-177.

1 **G. Adjustment for Days of Use (Rent-Vehicles).**

2 Staff reduces the rent paid for vehicles based on a wholly unsupported schedule that
3 purports to reduce vehicle costs based on how many work days a month the vehicles are used.
4 Even if the lack of support is ignored, the adjustment does not make sense. As explained in the
5 Rebuttal Testimony of Mr. Jones,⁸³ Staff is creating an alternate reality that assumes a truck or
6 forklift can be rented at a monthly rate, but paid for on a per day per use basis. This is not
7 possible. Every utility has business needs which require it to have vehicles that are not used each
8 and every day. There is no free lunch--the vehicle must be paid for every day. Staff's
9 mathematical factoring of cost does not change this reality.

10 At the hearing, Mr. Jones explained further the fallacy of Staff's adjustment:

11 A. ... Adjustment 11.B under Rent Vehicles is a substantially different type
12 of adjustment. The company also rents some trailers, forklifts and
13 equipment, and Staff has proposed a factoring based on the number of
14 days throughout the year it's actually used. The company doesn't believe
15 that sort of factoring is appropriate. You must rent -- to have something
16 available to use, you have to have it rented every day of the year. You
can't just rent it on a daily or hourly basis when it's needed. And these are
typical vehicle and equipment that all utilities own or lease or rent, and it
should be appropriately included in the company's expenses.

17 Q. Mr. Jones, because this one, this particular adjustment initially was a little
18 confusing to me, but I'm going to just ask you, give you an example, and
19 see if my example is in the kind of, approximately close to what Staff is
20 proposing here. Is this adjustment like renting a car and having possession
of that car for a full month, but only using that car on four or five days out
of the month and expecting that you would simply pay an allocated
portion of the rent based only on the days that you used the vehicle?

21 A. Yes, that's exactly the method Staff has used on this adjustment.⁸⁴

22 The vehicle expense submitted by New River in this case is reasonable and should be
23 adopted.

24 **H. Removing Expenses for One Work Truck (Transportation Expense).**

25 This adjustment by Staff removes the transportation expense associated with the truck that
26 Staff has removed from vehicle rent expense. Accordingly, if the ALJ rejects the Staff

27 _____
28 ⁸³ Hearing Exhibit A-3 (Jones Rebuttal) at 22, lines 9-16.

⁸⁴ Hearing Transcript Vol. I at 31-32.

1 adjustment to remove one vehicle from vehicle rent expense, then the ALJ should similarly reject
2 this companion adjustment.

3 **I. Alleged "Normalization" of Bad Debt Expense.**

4 New River proposed bad debt expense of \$7,688 based on the actual test-year bad debt
5 expense. However, Staff reduced bad debt expense by \$5,125 to \$2,563, ostensibly on the
6 grounds that it was "normalizing" bad debt expense over three years.⁸⁵ Because New River did
7 not book bad debts separately from revenues during the two years preceding the 2011 test-year,
8 bad debt expense for those years is unknown and unrecorded. Mr. Jones testified in his Rebuttal
9 Testimony that "[t]he Company changed its accounting practice for the test year specifically so it
10 could identify its bad debt expense and seek appropriate recovery of the actual expense."⁸⁶ In
11 making its adjustment, Staff used zero bad debt expense for each of the two years preceding the
12 test-year. Such methodology does not normalize bad debt expense, it simply divides the actual
13 test-year bad debt expense by three.⁸⁷ This is not reasonable or fair under the circumstances of
14 this case.

15 Clearly, there is no likelihood that two years of zero bad debt expense out of three reflects
16 reality.⁸⁸ In fact, Staff witness Brown agrees, as shown by the following exchange on cross-
17 examination:

18 Q. Ms. Brown, on bad debt expense, your normalization of bad debt expense
19 assumes that the company had no bad debt expense in each of the two
20 years prior to the test year; is that correct?

21 A. That's correct.

22 Q. And what do you think the likelihood is that the company had no bad debt
23 expense in two consecutive years?

24 A. I think the likelihood is low.

25 Q. Almost close to zero, would you say?

26 A. Yes. Yes.⁸⁹

27 ⁸⁵ Hearing Exhibit S-1 (Brown Direct) at 45-46.

⁸⁶ Hearing Exhibit A-3 (Jones Rebuttal) at 22-23.

⁸⁷ Hearing Exhibit A-3 (Jones Rebuttal) at 22, lines 23-27.

⁸⁸ Hearing Transcript Vol. I at 33, lines 8-12.

1 Mr. Jones testified in his Rebuttal Testimony that the \$7,688 in test-year bad debt expense
2 “represents a write-off rate of 0.6% and is the actual bad debt for the test year.”⁹⁰ This is a low
3 rate of bad debt expense by any standard, and it should not be lowered further by Staff’s artificial
4 adjustment. On September 30, 2013, New River late-filed the Affidavit of Ray L. Jones in
5 Support of Late-Filed Exhibits. In his affidavit, Mr. Jones reported that the bad debt expense of
6 New River for calendar year 2012 was \$12,699.60.⁹¹ This level of bad debt expense supports the
7 test-year bad debt expense of \$7,688.

8 The evidence supports the actual test year bad debt expense of \$7,688. As stated by Mr.
9 Jones, “[t]his level of bad debt expense was actually incurred by the Company during the test year
10 and is the best available indication of the level of bad debt that will be incurred in the future.”⁹²
11 Staff’s adjustment to bad debt expense should be rejected.

12 **J. Depreciation Expense.**

13 The differing depreciation expenses recommended by the parties are the result of their
14 differing positions on accumulated depreciation, depreciation method and inadequately supported
15 plant as discussed above. Most of the difference is attributable to applying agreed upon
16 depreciation rates to differing plant balances. To the extent that the plant balance disputes and the
17 scope of using the vintage year procedure are resolved, the correct depreciation expense (and
18 related amortization of contributions in aid of construction) will resolve automatically as a result
19 of that process. It should be noted that the differing recommend depreciation rates for the
20 pumping equipment account discussed in Section II.C above are related to the differing
21 accumulated depreciation restatement recommendations. If New River’s recommended
22 restatement is adopted, then the Company’s recommended depreciation rate of 8.0% for the
23 pumping equipment account should be adopted. However, if Staff’s recommended restatement is
24 adopted, then Staff’s recommended depreciation rate of 12.5% for the pumping equipment
25 account should be adopted.

26 ⁸⁹ Hearing Transcript Vol. II at 359, lines 7-16.

27 ⁹⁰ Hearing Exhibit A-3 (Jones Rebuttal) at 22, lines 23-24.

28 ⁹¹ Affidavit of Ray L. Jones in Support of Late-Filed Exhibits dated September 30, 2013, and
filed in Docket W-01737A-12-0478.

⁹² Hearing Exhibit A-4 (Jones Rejoinder) at 12, lines 21-23.

1 his Rebuttal Testimony, and the recent Global Water rate case Staff recommendation and
2 settlement agreement.⁹⁵

3 In his Surrebuttal Testimony, Staff witness John Cassidy provided a restatement of Mr.
4 Jones' Table 2 correcting three minor errors in Table 2.⁹⁶ The restatement is attached as
5 Surrebuttal Exhibit JAC-A to Mr. Cassidy's Surrebuttal Testimony, and a copy is attached hereto
6 for convenience as Attachment 2. Exhibit JAC-A shows authorized returns on equity for 10
7 utilities ranging from a low of 8.82% for Bermuda Water Company to a high of 10.55% in the
8 most recent rate case decision, Arizona Water Company (Eastern Group). Mr. Cassidy calculates
9 an average authorized return on equity for these 10 companies of 9.83%. The difference between
10 Staff's recommendation on cost of equity in this case and the average authorized return on equity
11 approved for 10 utilities referenced above is nearly 100 basis points.

12 In the pending Global Water Resources consolidated rate cases in Docket No. W-01212A-
13 12-0309 *et al.* (the "Global Rate Case"), Mr. Cassidy recommended that the Global Water receive
14 a 9.4% cost of equity. Then, on August 13, 2013, most of the parties in the Global Rate Case
15 filed a settlement agreement which would, if approved, authorize a 9.5% return on equity. The
16 difference between Staff's recommendation on cost of equity in this case and the Global Rate
17 Case settlement agreement return on equity is 60 basis points.

18 There is simply no way for Staff to defend the sizeable differential between its
19 recommendation in this case (8.90%), its recommendation in the Global Rate Case (9.40%), the
20 Global Rate Case settlement agreement cost of equity (9.50%), and the average authorized rates
21 of return in the 10 recent rate case decisions (9.83%). Addressing the deficiencies in Staff's Cost
22 of Capital analysis, Mr. Jones testified as follows in his Rebuttal Testimony:

23 It verifies my long-held concern that Staff is over reliant on models that are
24 subject to unreasonable and sudden shifts in the model output over relatively short
25 periods of time as inputs change. Clearly, cost of equity does not shift
26 dramatically from day to day as Staff's model would indicate. It seems to me that
27 these models are, in the end, unreliable and unpredictable tools for determining
28 the cost of equity, particularly for smaller companies such as New River that do

⁹⁵ Hearing Exhibit A-4 (Jones Rejoinder) at 18, lines 16-19.

⁹⁶ Hearing Exhibit A-5 (Cassidy Surrebuttal) at Exhibit JAC-A.

1 not have the sophistication or resources to produce their own competing cost of
2 equity model. The glaring differences in the New River recommendation, as
3 compared to the Global Water recommendation, also raises the concern that Staff
4 could manipulate inputs in order to get a predetermined result from their cost of
5 equity model.⁹⁷

6 Staff witness Cassidy testified that the “primary shortcoming” of Mr. Jones’ cost of
7 capital analysis is that it contains “no formal market-based cost of equity analysis.”⁹⁸ Yet, Mr.
8 Cassidy’s own cost of capital model requires a 60 basis point upward economic assessment
9 adjustment in order to produce what Staff believes is a reasonable cost of equity.⁹⁹ According to
10 Mr. Cassidy, the economic assessment adjustment is intended to address “the relatively uncertain
11 status of the economy and the market that currently exists.”¹⁰⁰ While Mr. Cassidy acknowledged
12 at the hearing that “every Utilities Division employee who is performing cost of capital analysis
13 as an expert witness for Staff ... is ... including an upward economic assessment adjustment,”¹⁰¹
14 Mr. Cassidy was unable to explain how the 60 basis point adjustment was determined other than
15 to state that it was determined at the Staff Director level (*i.e.*, Mr. Olea).¹⁰²

16 Similarly, Mr. Cassidy was unable to quantify the “relatively uncertain status of the
17 economy and the market that currently exists” which forms the support for Mr. Olea’s 60 basis
18 point upward economic assessment adjustment:

19 Q. Mr. Cassidy, do you have a definition of the factors that are outlined in
20 your testimony at page 34, lines 9 and 10, which are the relatively
21 uncertain status of the economy and the market that currently exists? Are
22 those factors, do they have definitions?

23 * * *

24 ALJ HARPRING: Have you quantified the uncertainties of the economy or of
25 the market that currently exists?

26 THE WITNESS: I have not.¹⁰³

27 ⁹⁷ Hearing Exhibit A-3 (Jones Rebuttal) at 29, lines 2-13.

28 ⁹⁸ Hearing Transcript Vol. II at 210, lines 1-4.

⁹⁹ Hearing Transcript Vol. II at 212-213.

¹⁰⁰ Hearing Exhibit S-4 (Cassidy Direct) at 34, lines 7-12.

¹⁰¹ Hearing Transcript Vol. II at 225, lines 13-25.

¹⁰² Hearing Transcript Vol. II at 227, lines 18-22.

¹⁰³ Hearing Transcript Vol. II at 229-230.

1 What Mr. Cassidy’s testimony clearly illustrates is that Staff must figuratively place its
2 finger on the scales in each and every case—to the tune of a 60 basis point upward economic
3 adjustment—in order to make Staff’s cost of capital model produce what Staff believes is a
4 reasonable outcome. However, there is a complete lack of evidence in the record to support that a
5 60 basis point adjustment is any more or less appropriate than a 100 basis point adjustment, as
6 shown by the following exchange at the hearing between counsel for New River and Mr. Cassidy:

7 Q. But Mr. Cassidy, do you know how Mr. Olea determined that 60 basis
8 points was the appropriate adjustment versus some other number?

9 A. I am not privy to, no.

10 Q. Okay. Mr. Cassidy, would you agree that the “relatively uncertain status
11 of the economy” factor is a subjective factor?

12 ALJ HARPRING: Mr. Crockett, I don’t think that he can answer that as he has
13 already told you that he doesn’t have knowledge of how
14 that number was reached.

15 MR. CROCKETT: Okay.

16 ALJ HARPRING: So if he doesn’t know how it was reached, he can’t tell you
17 whether it was reached objectively or subjectively.¹⁰⁴

18 As Mr. Jones testified, the cost of equity in the real world does not shift dramatically from
19 day to day as Staff’s cost of capital model would indicate.¹⁰⁵ By way of illustration, the Global
20 Rate Case and the New River rate case have been proceeding on similar time tracks. The Global
21 Rate Case was filed on July 9, 2012, and the New River rate case was filed November 29, 2012.
22 Mr. Cassidy filed cost of capital direct testimony in the Global Rate Case on July 8, 2013, and he
23 filed cost of capital direct testimony in this case on June 26, 2013. However, notwithstanding the
24 close proximity in the testimony filing dates, Mr. Cassidy recommended a cost of equity of 9.4%
25 for the Global group of utilities and an 8.8% cost of equity for New River.¹⁰⁶ This is a large and

25 ¹⁰⁴ Hearing Transcript Vol. II at 228, lines 5-18.

26 ¹⁰⁵ Hearing Exhibit A-3 (Jones Rebuttal) at 29, lines 5-6.

27 ¹⁰⁶ Hearing Exhibit S-4 (Cassidy Direct) at p. 3, lines 5-10. In his Surrebuttal Testimony, Mr.
28 Cassidy subsequently increased his recommended cost of capital to 8.9%, which is his current
recommendation. However, the Global Rate Case settlement agreement provides for a cost of
capital of 9.5%, so there remains a 60 basis point differential between the cost of capital for New
River and the cost of capital for the Global utilities under the settlement agreement.

1 unsupportable differential of 60 basis points, and it is indefensible based upon the evidentiary
2 record in this case. The following exchange between the ALJ and Mr. Cassidy is particularly
3 instructive:

4 Q. What impact, if any, did the company's capital structure have on your
5 analysis?

6 A. None. The cost of equity, the market-based cost of equity analysis is done
7 independent of that; and as I indicated in my direct testimony and as I
8 stated here in cross-examination, no adjustment was made. The
9 circumstances perhaps would have warranted such an adjustment; but no,
10 there was no effect. No.

11 Q. Okay. Did the type of entity have any impact, the fact that the company is
12 a small and closely-held company as opposed to a larger company held by
13 either a large parent or individual stockholders?

14 A. Did that impact?

15 Q. Have any impact, right.

16 A. No. No. Again, the cost of equity analysis is independent of those factors,
17 so no, they did not enter into my recommendation.

18 Q. And your analysis performed in the New River case and in the Global case
19 used the same models, correct?

20 A. That is correct.

21 Q. And with the exception of the addition of York, as I recall, used the same
22 companies as a sample group?

23 A. That is correct.

24 Q. But the timing was different?

25 A. Yes, correct.

26 Q. And is that to what you would principally attribute the difference in the
27 outcomes?

28 A. Yes. Yes.

 A difference of a few weeks should not create a 60 basis-point difference in Staff's
recommendation on Cost of Capital. For the reasons discussed above, Staff's recommended cost
of equity for New River is too low. New River requests that the ALJ follow Mr. Jones'

1 recommendation for a 10.00% cost of equity, less a 1.28% fair value inflation adjustment, for a
2 fair value adjusted equity return of 8.72%.¹⁰⁷

3 **V. RATE DESIGN.**

4 Staff's rate design filed with Ms. Brown's Surrebuttal Testimony had some sort of
5 problem which caused it to produce significantly more revenue than was recommended by
6 Staff.¹⁰⁸ Staff filed revised Surrebuttal schedules including a revised rate design on September 5,
7 2013. The first opportunity that New River had to address Staff's revised rate design was at the
8 hearing on September 12, 2013. At that hearing, Mr. Jones testified regarding his concerns about
9 Staff's proposed rate design in response to a question from the Company's counsel:

10 Q. And do you have criticisms and concerns with this rate design proposed by
11 Staff?

12 A. Yes, I do. To be clear, this rate design is correct in the sense that it does
13 produce the correct amount of revenue now. So that is no longer the
14 concern. Or at least in theory it produces the correct amount of revenue.
15 There's no error in the computation any longer.

16 The nature of my concern now is the actual design of the rates, and
17 specifically this rate design places a very significant portion of the
18 revenues, and particularly the increase, into the third or highest rate tier;
19 and that gives me great concern that New River will not be able to earn its
20 authorized amount of revenue or its authorized rate of return.¹⁰⁹

21 Mr. Jones testified further:

22 A. Here in Arizona, almost all water companies now have what is known as
23 an inverted tiered rate design. What that means is, the more water
24 customers use, they move into different tiers. In each tier, the cost, the
25 unit cost or the cost per thousand gallons is more than the tier below it. So
26 the more water you use, the more it costs, not only in total, but the more it
27 costs on an incremental basis.

28 The purpose of these rate designs is to drive water conservation. At least
one of the primary purposes is to drive water conservation. And they
work, and they work well. And that's really the nature of my issues with
Staff's rate design.

¹⁰⁷ Hearing Exhibit A-4 (Jones Rejoinder) at 18, lines 15-16.

¹⁰⁸ Hearing Transcript Vol. I at 37, lines 18-22.

¹⁰⁹ Hearing Transcript Vol. I at 38, lines 3-17.

1 This rate design is so steeply inverted, if you will, and the change – and
2 there’s really two issues. It’s not only how steep the actual rate design is.
3 It’s also how fast are you moving in terms of the difference between the
4 current rate design and the proposed rate design.

5 And so I’m looking at both of those issues. I’m looking at what is the
6 actual rate design, but also what has been done in terms of the movement
7 or the rate of change. And it’s important to look at both the rate of change
8 as well as the end point, and this analysis attempts to look at both of those
9 issues.¹¹⁰

10 To analyze Staff’s proposed rate design, Mr. Jones prepared a schedule which was
11 admitted at the hearing as Hearing Exhibit A-7. Lines 6 of Hearing Exhibit A-7 shows that New
12 River allocated its proposed increase in rates relatively evenly between the base charge
13 (\$268,411), the Tier 1 plus Tier 2 rates (\$207,806), and the Tier 3 rate (\$285,489). By
14 comparison, however, Line 7 shows that Staff allocated only a very small portion of its proposed
15 increase in rates to the base charge (\$25,987), a slightly larger portion to the Tier 1 plus Tier 2
16 rates (\$75,784), and the great majority to the Tier 3 rate (\$358,502).

17 Lines 9-12 of Hearing Exhibit A-7 show how New River and Staff have allocated their
18 proposed percentage increases in rates across the tiers. New River is proposing a rate increase of
19 61.7%, and the Company has attempted to apply the increase somewhat consistently across the
20 tiers,¹¹¹ increasing the base charge by 60%, the Tier 1 plus Tier 2 rates by 47.2%, and the Tier 3
21 rate by 82.2%. Staff, by comparison, is proposing a rate increase of 37.3%, but increases the base
22 charge by only 5.8%, the Tier 1 plus Tier 2 rates by only 17.2%, and the Tier 3 rate by a very
23 substantial 100.3%.

24 At the hearing, Mr. Jones acknowledged that New River’s rate design must become more
25 conservation-oriented, and explained the philosophy of his proposed rate design:

26 A. Staff and the company are in agreement that the rate design needs to
27 become more conservation-oriented than it currently is. The company
28 currently has an inverted tier; but the tier, the difference between the tiers
is very small. So there’s no disagreement that the company’s rate design
should become more conservation-oriented than it is today.

¹¹⁰ Hearing Transcript Vol. I at 39-40.

¹¹¹ Hearing Transcript Vol. I at 41, lines 15-17.

1 The difference really comes into how conversation-oriented does it
2 become in this iteration, and how fast do you get there, I guess is part of
3 that as well. And so these percentages start to get to that.

4 And what this shows you, looking at line 10 is, the theory I used was – and
5 I tend to try to use this in all cases, unless there's some kind of problem
6 with the base charge. If the base charge is relatively reasonable as a
7 percentage of revenue, then I will always try to increase the base charge at
8 roughly the same percentage as the overall rate increase; and that's to
9 provide revenue stability for the company. And it's the first step in
10 making sure that they can collect their revenue requirement.

11 Q. Okay. So on this chart, because the company is proposing a 61.7 percent
12 increase in revenue, you increase the base charge by 60 percent?

13 A. That's right, roughly the same. But, recognizing that the rate structure
14 needed to become more conservation-oriented, I raised the first and
15 second tier by 47 percent, which is substantially lower than the overall,
16 and raised the third tier by 82 percent which is higher than the overall.

17 In contrast, if we move to line 11, Staff has increased the base charge by
18 only 5.8 percent as compared to their overall recommendation of 37.3. I
19 think that is a mismatch. Absent some sort of evidence that the company's
20 existing rates have too much of its revenue in base charges, there's no
21 justification for that kind of differential between the increase in the base
22 charges and the increase in the overall increase.

23 And then if we look at their first and second tier versus the third tier, you
24 can see why mine were somewhat different. Theirs are really wildly
25 different, with the first and second tier only going up by 17.2 percent and
26 the third tier going up over a hundred percent.¹¹²

27 Lines 13-15 of Hearing Exhibit A-7 calculate the increase in rates by tier as a percentage
28 of the overall increase. Line 14 shows that for New River, Mr. Jones increased the base charge
by 97.2% of the overall increase, or roughly the same (100% would be exactly the same). On line
15, by comparison, Staff increased the base charge by a meager 15.6 percent of the overall
increase. Recognizing, again, the need for a more conservation-oriented rate design, Mr. Jones
increased the Tier 1 and Tier 2 rates by 76.6% of the overall increase while raising the Tier 3
rates by 133.3% of the overall increase. Mr. Jones explained that his rate design strikes “a pretty
good balance, and it's not making a drastic movement to the third tier that would cause revenue

¹¹² Hearing Transcript Vol. I at 42-43 (emphasis added).

1 instability.”¹¹³ The Staff rate design, by comparison, is very problematic, as explained by Mr.
2 Jones:

3 A. In contrast, if you look at those same two columns on line 15 for Staff,
4 they raised the tier 1 and 2 rates by 46.2 percent, or less than half of the
5 overall increase; and really incredibly, the third tier went up by, it's 277
6 percent of the overall, or another way to state that would be 2.77 times the
7 overall rate of increase. So it's really loading all the new revenue into the
8 third tier, is what their rate design does.

9 * * *

10 Q. Well, is the concern that when a customer gets their first bill or two, they
11 will recognize that getting into that third tier, it really significantly impacts
12 their bill, so they go out and they start turning down their sprinklers and
13 maybe removing grass, doing all those kinds of things to get real
14 conservation-minded on the use of water?

15 A. Exactly. That's the result is that this rate design will significantly drive
16 water conservation, but it's more than that. It not only drives water
17 conservation. It places the vast majority of all the rate increase in the
18 water conservation tier, if you will, where that revenue is all at risk.

19 And the next set of percentages really bring that home. What this
20 calculates is what percentage of the increase is inside of each tier. And so
21 if we look at line 18, with respect to the increase, my rate design captures
22 ... 35.2 percent of the increase in the base charge, 27.3 in the middle tiers,
23 1, 2, and 37.5 percent in the third tier. Those three will total up to 100
24 percent of the increase.

25 In contrast, Staff only captures 5.6 percent of the increase in the base
26 charges, only 16.5 percent in the middle tiers, and 77.9 percent of all the
27 increase that Staff recommends is awarded in the third tier under their rate
28 design, which makes it very susceptible to conservation, which the rates
are designed to accomplish, will most certainly accomplish, and what the
end result is, in the ratemaking manuals, you would talk about it as
revenue instability, and it will produce revenue instability for the
company, both in terms of the total revenue it can collect, which will be
less than authorized, but it also will force – it exacerbates the seasonal
issues. It will drive massive amounts of revenue into the summer, and,
you know, make the differences between summer and winter revenues
even greater, which is another revenue instability issue that I'm trying to
avoid.

And so, you know, the two numbers in my mind that really lead me to
object to Staff's rate design are line 15, column C, the 277 percent of the

¹¹³ Hearing Transcript Vol. I at 44, lines 22-25.

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overall – tier 3 is increased by 277 percent of the overall increase. And then column C, line 19, that means that 77.9 percent of all the increase is captured in that third tier. Those are the two key numbers in my mind that make Staff’s rate design flawed, and lead me to believe there’s going to be significant revenue instability for New River and that that rate design should not be adopted.

* * *

Q. Mr. Jones, if Staff’s rate design is adopted, will New River have a reasonable opportunity to earn its rate of return?

A. I don’t believe they will. I think this rate design would lead to significant water conservation that would certainly lead to under-earning by New River.¹¹⁴

Unlike Mr. Jones, Staff did not calculate (i) a Percentage Increase by Tier, (ii) an Increase by Tier as Percentage of Overall, (iii) a Percentage of Overall Increase Within Tier, (iv) a Percentage of Total Revenue by tier, or (v) a Change in Percentage of Total Revenue by tier.¹¹⁵ Without these critical calculations, it is unlikely that Staff was able to ascertain the rate instability that will result from the adoption of its proposed rate design.

No Staff witness contradicted or rebutted in any way the calculations provided in Hearing Exhibit A-7 and the testimony of Mr. Jones at the hearing. Simply stated, Staff’s rate design is flawed and, if adopted, will cause significant revenue instability for New River. Thus, New River requests that the ALJ adopt its proposed rate design and reject Staff’s proposed rate design.

VI. CONCLUSION.

New River Utility Company respectfully requests that the ALJ adopt its recommendations on the remaining disputed issues for the reasons stated above and in the pre-filed and live testimonies of the Company’s witness.

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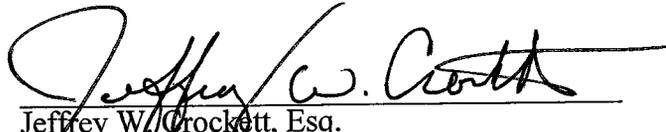
¹¹⁴ Hearing Transcript Vol. I at 45-47 and 49, lines 17-22 (emphasis added).
¹¹⁵ Hearing Transcript Vol. II at 360, lines 3-25.

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RESPECTFULLY submitted this 25th day of October, 2013.

BROWNSTEIN HYATT FARBER SCHRECK LLP



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this 25th day of October, 2013, with:

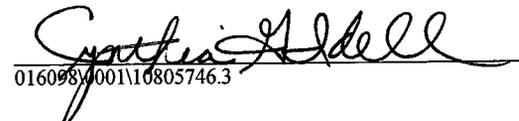
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COPY of the foregoing hand-delivered
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ATTACHMENT 1

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

KRISTIN K. MAYES, Chairman

GARY PIERCE

BOB STUMP

PAUL NEWMAN

SANDRA D. KENNEDY

IN THE MATTER OF THE APPLICATION OF
ARIZONA-AMERICAN WATER COMPANY,
AN ARIZONA CORPORATION, FOR A
DETERMINATION OF THE CURRENT FAIR
VALUE OF ITS UTILITY PLANT AND
PROPERTY AND FOR INCREASES IN ITS
RATES AND CHARGES BASED THEREON
FOR UTILITY SERVICE BY ITS AGUA FRIA,
HAVASU AND MOHAVE WATER DISTRICTS

DOCKET NO. W-01303A-10-

**DIRECT TESTIMONY
OF
IAN C. CROOKS, P.E.
ON BEHALF OF
ARIZONA-AMERICAN WATER COMPANY
NOVEMBER 3, 2010**

**DIRECT TESTIMONY
OF
IAN C. CROOKS, P.E.
ON BEHALF OF
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NOVEMBER 3, 2010**

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1 **EXECUTIVE SUMMARY**

2 Mr. Crooks testifies as follows:

3 The gross amount of actual White Tanks Plant O&M expense deferred before subtraction of cost
4 savings resulting from the production shifts from wells to White Tanks Plant was \$671,765
5 through June 30, 2010. The gross amount of actual cost savings resulting from operating the
6 White Tanks Plant was \$121,248 as of June 30, 2010. The net deferral, therefore, as of June 30,
7 2010 is \$550,842. This is not the total amount of the White Tanks O&M net deferral being
8 requested for recovery in rates in this case because O&M expense continues to be incurred and
9 deferred until new rates are effective and the deferral's recovery commences.

10 The Company has included the net deferral amounts through the period November 30, 2011, the
11 date estimated for when new rates in this case will be implemented. Total gross White Tanks
12 Plant O&M expense from in-service through November 30, 2011, is currently estimated to be
13 \$3,057,025, the gross realized production savings to be \$639,890, and the authorized cost of
14 accrued interest at the prevailing short-term interest rate to be \$24,672, for a net total deferral of
15 \$2,441,807.

16 The Company is proposing two changes to irrigation class customers. First, the Company seeks
17 to modify the format of the existing tariff to provide clarity to the customers and Company
18 regarding irrigation use. The proposed tariff will clearly explain to the customers and Company
19 the availability, applicability, special conditions, rates, and terms and conditions for irrigation
20 service. Second, the Company proposes through rate design to expand the irrigation class from a
21 single tier rate with no minimum monthly charge to a single tier rate but with a minimum
22 monthly service charge based on meter size.

23 The tank maintenance plan for Agua Fria is based on a 15-year schedule for recommended
24 repairs and painting. The estimated yearly maintenance expense annualized over the 15-year
25 cycle is estimated to be \$376,478. It is anticipated that this estimated expense would be
26 available for review and adjustment when necessary in subsequent Agua Fria Water District rate
27 cases.

1 **I INTRODUCTION AND QUALIFICATIONS**

2 **Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND TELEPHONE**
3 **NUMBER.**

4 A. My name is Ian C. Crooks. My business address is 15626 North Del Webb Boulevard,
5 Sun City, Arizona. 85351. My business phone is 623-445-2404.

6 **Q. IN WHAT CAPACITY AND BY WHOM ARE YOU EMPLOYED?**

7 A. I am employed by Arizona-American Water Company ("Arizona-American Water" or
8 the "Company") as the Director of Central Division Operations, which includes the Sun
9 City Water and Wastewater Districts, Sun City West Water and Wastewater Districts, and
10 Agua Fria Water and Wastewater Districts.

11 **Q. PLEASE DESCRIBE YOUR PRIMARY RESPONSIBILITIES FOR THE**
12 **COMPANY.**

13 A. I am responsible for the operation of the water production, water distribution, wastewater
14 treatment, and wastewater collection facilities.

15 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.**

16 A. I received a Bachelor of Science degree in Environmental Engineering from
17 Pennsylvania State University in 1994. I have also completed various water-related
18 technical courses that include water production and distribution, wastewater treatment,
19 water distribution, water quality protection, cross-connection control, and water and
20 wastewater management.

21 **Q. ARE YOU A REGISTERED PROFESSIONAL ENGINEER OR CERTIFIED**
22 **OPERATOR?**

23 A. Yes. I am a registered Professional Engineer in the states of Arizona and Pennsylvania
24 and certified as an ADEQ Grade 2 Water Distribution System Operator.

1 **Q. PLEASE DESCRIBE YOUR PROFESSIONAL EXPERIENCE.**

2 A. I joined Arizona-American Water in 2006. My role since January 2010 is Director of
3 Operations for Central Division where I am responsible for the operation and business
4 performance of the Company's water and wastewater services in the Sun City, Sun City
5 West, and Agua Fria Districts. Prior to becoming the Director of Operations, I held the
6 position of Engineering Manager of Developer Services for the Company. I was
7 responsible for the agreements, design, planning, construction, budgeting, and
8 compliance related to development activity for all state districts. Prior to this role, I held
9 the position of Sr. Operations Engineer of Developer Services.

10 Prior to joining the Arizona-American, I was employed from 2005 to 2006 by NVR, Inc.,
11 a national homebuilder, as the Land Development Manager. Before that, from about
12 1996 forward I was employed by Pennsylvania-American Water Company in Coatesville,
13 Pennsylvania district as Sr. Engineer and for some duration as IT Manager. Prior to that,
14 from 1994 to 1996, I was Engineering Supervisor for Erie City Water Authority. Lastly,
15 my career in the water industry began in 1994 as a water treatment plant operator for the
16 City of Harrisburg Authority.

17 **Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THIS COMMISSION?**

18 A. Yes, in Arizona-American's two most recent rate cases (Docket No. W-01303A-08-0227
19 and Docket No. W-01303A-09-0343).

20 **II WHITE TANKS PLANT O&M DEFERRAL (AGUA FRIA)**

21 **Q. DECISION NO. 71410 AUTHORIZED THE COMPANY TO DEFER ACTUAL**
22 **NET WHITE TANKS PLANT O&M EXPENSE FROM ITS IN-SERVICE DATE**
23 **UNTIL NEW RATES ARE EFFECTIVE. HOW MUCH IS THE DEFERRAL AS**
24 **OF THE END OF THE TEST YEAR JUNE 30, 2010?**

1 A. The gross amount of actual White Tanks Plant O&M expense deferred before subtraction
2 of cost savings resulting from the production shifts from wells to White Tanks Plant was
3 \$671,765 through June 30, 2010. The gross amount of actual cost savings resulting from
4 operating the White Tanks Plant was \$121,248 as of June 30, 2010. The net deferral,
5 therefore, as of June 30, 2010 is \$550,842 (*i.e.*, \$671,765 in White Tanks Plant O&M
6 minus \$121,248 in production savings elsewhere plus accrued interest costs of \$325).¹
7 However, this is not the total amount of the White Tanks O&M net deferral being
8 requested for recovery in rates in this case because O&M expense continues to be
9 incurred and deferred until new rates are effective and the deferral's recovery
10 commences.

11 **Q. WHAT IS THE ESTIMATED DEFERRAL AT NOVEMBER 30, 2011?**

12 A. Since Decision No. 71410 indicates that the net deferral - through the date when the next
13 rate order authorizes recovery of these expenses as on-going expenses - shall be
14 recoverable, the Company has included the net deferral amounts through the period
15 November 30, 2011. This is the date estimated for when new rates in this case will be
16 implemented. Total gross White Tanks Plant O&M expense from in-service through
17 November 30, 2011, is currently estimated to be \$3,057,025, the gross realized
18 production savings to be \$639,890, and the authorized cost of accrued interest at the
19 prevailing short-term interest rate to be \$24,672, for a net total deferral of \$2,441,807.
20 This total deferral is being requested for recovery in rates over a three-year amortization
21 period without any carrying costs beyond November 30, 2011, by Company witness Mr.
22 Sandra L. Murrey in Adjustment SLM-1 of Schedule C-2.¹ In the event this case's
23 decision occurs after November 30, 2011, the supporting work papers for this adjustment

¹ The detail of the White Tanks Plant deferral amortization is displayed on Page 24, Line 5, of the adjustment summary supporting Adjustment SLM-1. There is further monthly documentation in work papers in a file titled "Amtzn of White Tanks O&M Deferral.xls" and "AF 2009 and 2010 Power and Chemical Costs 10.13.2010.xls."

1 contain all of the necessary information to extend the quantification of the deferral out to
2 June 30, 2012.

3 **Q. HOW DID YOU DETERMINE THE OFFSETTING PRODUCTION SAVINGS**
4 **DUE TO THE WHITE TANKS PLANT OF \$639,890?**

5 A. The savings is attributable only to the reduction in power and chemical expenses in the
6 Agua Fria Water District (excluding the White Tanks Plant) resulting from the reduced
7 well production because these costs are variable costs which fluctuate directly with
8 production elsewhere in the District. White Tanks production displaces what otherwise
9 would be well production. White Tanks production is delivered to the Aqua Fria District
10 approximately 300 days each year, depending on shutdown of the canal for maintenance.
11 Therefore, I examined Agua Fria district power and chemical expense for the twelve-
12 month period immediately before in-service of the White Tanks Plant and concluded that
13 power and chemicals expenses from December 1, 2008 thru November 30, 2009 would
14 be a reasonable baseline for comparison for periods subsequent to White Tanks Plant
15 being in-service. Again, for periods that actual savings are available, I used actual data
16 in comparison to the baseline, but for beyond and through November 30, 2011, I used the
17 annualized production cost savings as discussed in that section of my testimony. The
18 historical baseline used for this purpose is displayed by month in the work paper file "AF
19 2009 and 2010 Power and Chemical Costs 10.13.2010.xls".

20 **Q. CAN THE COMPANY PROVIDE PERIODIC UPDATES OF THE ACTUAL NET**
21 **O&M DEFERRAL?**

22 A. Yes, as additional actual information becomes available due to the passage of time on
23 White Tanks Plant O&M and the offsetting production savings, the Company will
24 provide additional updates in subsequent rounds of testimony, at hearings, in final
25 schedules and at any other time as requested.

1 **Q. HOW DID THE COMPANY DETERMINE WHAT GROSS WHITE TANKS**
2 **O&M EXPENSES WERE APPROPRIATE AS AUTHORIZED TO DEFER?**

3 A. For capturing actual expenses, the Company established a new business unit #236150 for
4 capturing only direct White Tanks O&M expenses. There were no corporate business
5 unit or service company costs charged or allocated to the deferred expenses except those
6 related to employee benefits for the six employees at White Tanks. From in-service date
7 through June 30, 2010, actual data was used. But for periods beyond and through to
8 November 30, 2011, the annualized White Tanks O&M expenses as discussed in that
9 section of my testimony were used. The gross deferred White Tanks O&M expenses
10 through November 30, 2011 – which rely upon the annualized figures – are derived in
11 work papers cited above.

12 **Q. HOW MUCH HAS WHITE TANKS PRODUCED SINCE ITS IN-SERVICE DATE**
13 **OF NOVEMBER 30, 2009?**

14 A. From in-service until the end of the test year June 30, 2010, White Tanks produced
15 1,050,740,000 gallons. White Tanks production on a monthly basis from in-service
16 through September 30, 2010 is as follows:

<u>Month</u>	<u>Volume (kgals)</u>	
11-2009	3,380	(1 day of operation)
12-2009	49,370	(canal shutdown on December 9th)
01-2010	0	(canal shutdown)
02-2010	11,200	(canal in-service February 23)
03-2010	171,967	(normal production volume)
04-2010	224,950	(reduced production, see Q&A in section III below)
05-2010	273,611	(normal production volume)
06-2010	316,262	(normal production volume)
07-2010	187,343	(reduced production, see Q&A in section III below)
08-2010	113,358	(reduced production, see Q&A in section III below)
09-2010	309,848	(normal production)
	1,661,289 kgals	

1 **III WHITE TANKS ANNUALIZED O&M (AGUA FRIA):**

2 **Q. SINCE ALL WHITE TANKS ACTUAL NET O&M WAS DEFERRED IN THE**
3 **TEST YEAR, IT IS NECESSARY TO INCLUDE AN ON-GOING ANNUALIZED**
4 **AMOUNT OF WHITE TANKS O&M IN THE AGUA FRIA DISTRICT COST OF**
5 **SERVICE. HOW MUCH HAS THE COMPANY INCLUDED IN RATES**
6 **REQUESTED IN THIS CASE?**

7 A. The Company included \$1,549,627 for a twelve-month normal operating period as
8 included by Company witness Ms. Linda J. Gutowski in various adjustments including
9 Adjustment LJG-20 on Schedule C-2.

10 **Q. DID THE COMPANY DETERMINE THE ANNUALIZED WHITE TANKS O&M**
11 **SIMPLY BY ANNUALIZING THE ACTUAL EXPENSE TO-DATE FOR**
12 **ADDITIONAL MONTHS?**

13 A. Yes and no. Yes, as it was appropriate for some categories of O&M expenses such as
14 labor and labor related, but no for some other categories, especially those expenses
15 sensitive to production volumes. Maintenance expenses during the test year at White
16 Tanks were below normal as discussed below.

17 **Q. WHY WERE WHITE TANKS PRODUCTION VOLUMES AND EXPENSE**
18 **LEVELS BELOW NORMAL FROM NOVEMBER 30, 2009 THROUGH JUNE 30,**
19 **2010?**

20 A. Both actual production volumes and (deferred) expense levels were below normal for a
21 number of reasons listed below:

- 22 1. Alamo Lake Release - March 28, 2010 thru April 20, 2010 - Due to heavy rains in
23 Arizona during the spring of 2010, Alamo Lake water was required to be released for
24 flood control. This release caused turbidity levels in the CAP canal to increase
25 significantly. As a result, the raw water turbidity at the plant climbed above the initial
26 design parameters of the plant and chemicals on-hand, making treatment difficult.
27 This required a reduction in plant production to maintain quality parameters. During

1 this event, some Agua Fria Water District wells were brought back on-line to
2 augment White Tank production to meet system demand.

3 2. Lake Pleasant CAP Construction - June 28, 2010 thru July 31, 2010 – A CAP canal
4 construction project commenced which required switching the canal source water
5 from Colorado River to Lake Pleasant. The Lake Pleasant water supply came from
6 the lake bottom, which again produced high raw water turbidity levels. The decision
7 was made for White Tanks to run at a reduced flow rate to maintain quality
8 parameters over the course of the construction schedule. During this event, some
9 Agua Fria Water District wells were brought back on-line to augment White Tank
10 production to meet system demand.

11 3. Mechanical Failure of the DAF Compressors – August 12, 2010 through August 23,
12 2010 - The DAF (dissolved air flotation) compressors failed, leaving the plant
13 incapable of treating the water. The DAF failure was the result of contractor error
14 during White Tanks construction. This shutdown continued until a backup
15 compressor was supplied and installed. Once installed the plant started production
16 again but at reduced flows while the temporary compressors were tested with
17 incrementally increased daily production rates. The plant returned to full production
18 on August 31. During this event, some Agua Fria Water District wells were brought
19 back on-line to augment White Tank production to meet system demand.

20 4. Lastly, maintenance expenses were below normal because most repair items were
21 replaced or repaired under the one-year construction warranty period. As operating
22 today, the White Tanks operations can be characterized as normal with the exception
23 of the maintenance items still under warranty until November 2010. Thus, the
24 process of continuing to update the deferral with actual data through the conduct of
25 this case will also be helpful to informing whether or not any changes to the
26 annualized White Tanks O&M expenses are appropriate.

27 In summary, these atypical events caused less White Tank production resulting in lower
28 power and chemical expenses than projected by the Company for a typical year of
29 production and demonstrate the importance of maintaining the operational availability of
30 all of the district's existing wells. For instance, from in-service to June 30, 2010 (test
31 year) total actual production was 1,050,740 thousand gallons (kgals) versus a projected
32 1,257,593 kgals, a difference of 206,853 kgals, and from in-service to September 30,
33 2010 total actual production was 1,661,289 kgals versus a projected 2,234,567 kgals, a
34 difference of 573,278 kgals.

1 **Q. GIVEN THAT PRODUCTION WAS BELOW NORMAL THROUGH JUNE 2010,**
2 **WHAT WAS YOUR SOURCE OF DATA FOR THE NON-LABOR**
3 **NORMALIZED WHITE TANKS PLANT O&M?**

4 A. I used the 2011 budget for the Aqua Fria District. In developing the budget, I accounted
5 for the reduced production in 2010 and adjusted the production variable non-labor O&M
6 expenses (power and chemical) to a normalized annual production based on historical
7 system demands with White Tanks running approximately 300 days a year without
8 interruption from the atypical events experienced in 2010. Additionally, I estimated
9 annualized maintenance repair expenses (pumps, mechanical, electrical, and other) based
10 on the repair expenses incurred under warranty to date by the contractor and other
11 anticipated future repairs.

12 **IV NEW IRRIGATION CLASS (ALL DISTRICTS)**

13 **Q. IS THE COMPANY REQUESTING THE FORMATION OF A NEW CLASS OF**
14 **IRRIGATION CUSTOMERS WHICH RECEIVE POTABLE WATER?**

15 A. Yes. The Company is proposing two changes to irrigation class customers. First, the
16 Company seeks to modify the format of the existing tariff to provide clarity to the
17 customers and Company regarding irrigation use. In the current Agua Fria tariff, for
18 example, the irrigation rate is simply a line item on the general rates table with no regard
19 to what defines an irrigation customer or the terms and conditions of service. In contrast,
20 the Company's Anthem tariff has separate pages for irrigation service that clearly explain
21 the applicable rates and terms of service. So, the Company is proposing to modify all
22 tariffs in this case in format and content to mirror the Company's Anthem Water District
23 tariff for irrigation service. The proposed tariff will clearly explain to the customers and
24 Company the availability, applicability, special conditions, rates, and terms and
25 conditions for irrigation service. Second, the Company proposes through rate design to
26 expand the irrigation class from a single tier rate with no minimum monthly charge to a

1 single tier rate but with a minimum monthly service charge based on meter size.
2 Although the tariffs for the districts in this rate case have existing irrigation rates, there
3 are very few customers on those schedules due to the lack of clear applicability under
4 existing tariffs. Therefore, the Company proposes to define a new irrigation customer
5 class and, upon implementation of new rates in this case, reclassify existing customers
6 into that class as applicable.

7 **Q. AS A RESULT OF THIS RE-CLASSIFICATION, HOW MANY CUSTOMERS**
8 **BY DISTRICT WILL BECOME IRRIGATION CUSTOMERS AS COMPARED**
9 **TO EXISTING IRRIGATION CUSTOMERS?**

10 A. Irrigation customers by district before and after are:

	<u>Existing</u>	<u>After</u>
11 Agua Fria	6	708
12		
13		
14		
15 Havasu	0	4
16		
17 Mohave	0	52
18		

19 **Q. WHY IS THE COMPANY RECOMMENDING THIS CHANGE?**

20 A. Given the emphasis today on water conservation, the Company believes it is appropriate
21 to define and group all of its customers using potable water for irrigation for future
22 benefits such as targeting water conservation programs or specific rate designs. After the
23 change is implemented, the Company will have identified all of its customers using both
24 potable and non-potable water for irrigation purposes.

25 **Q. DO THE RATES REQUESTED IN THIS CASE NOW REFLECT THE VALUE**
26 **OF POTABLE VERSUS NON-POTABLE WATER FOR IRRIGATION**
27 **CUSTOMERS?**

1 A. Yes. In Agua Fria district in particular, rates proposed in this case are lowest for treated
2 effluent (e.g., Verrado), raw surface water (e.g., Verrado), raw untreated non-potable
3 groundwater (e.g., Corte Bella) and lastly, highest for potable water.

4 **V TANK MAINTENANCE PROGRAM (AGUA FRIA)**

5 **Q. PLEASE EXPLAIN THE PROPOSED TANK MAINTENANCE PROGRAM FOR**
6 **THE AGUA FRIA WATER DISTRICT.**

7 A. In 2010, the Agua Fria Water District procured the services of Tank Industry Consultants
8 (“TIC”) to perform inspection on the oldest tank in the Agua Fria Water District, WP 2
9 Tank 1, as age is typically the best indicator of maintenance needs. The Agua Fria Water
10 District has sixteen water storage tanks with construction dates ranging from 1996 to
11 2009. TIC is a professional engineering firm specializing in the design, specification, and
12 evaluation of storage tanks. TIC has offices located throughout the United States and is a
13 national leader in this type of activity.

14 The scope of services performed by TIC included the performance of a careful study of
15 the tank’s interior, exterior, foundation(s) and accessories with a NACE-certified
16 inspector. The resulting report provided to Arizona-American by TIC - which is
17 available in discovery - included a detailed analysis of the tank’s condition,
18 recommended maintenance activities, suggested schedule of repairs, and an engineer’s
19 estimate of the cost to perform those repairs. The report also included the signature and
20 seal of a Certified Professional Engineer registered in the State of Arizona.

21 The following activities were noted in the TIC inspection reports:

- 22 1. Observations of site conditions, including observations of site access, general site
23 security, site maintenance and foundation deficiencies.
- 24 2. Observations of tank exterior conditions, including observations of dimensions of all
25 manholes, vents, condition of exterior coating thickness, coating adhesion and metal
26 corrosion, and baseline dimensions for comparison.

- 1 3. Observation of tank interior conditions, including observations of condition of
2 coating thickness, coating adhesion, metal corrosion, and observation of any debris,
3 and baseline conditions for comparison.
- 4 4. Recommendations based on all observations, including recommendations on site
5 maintenance procedures and security, life of the interior and exterior coatings and
6 metals, coating rehabilitation methods and rehabilitation schedules and tank rigging
7 equipment repair and replacement.

8 **Q. WHAT IS THE PLAN FOR TANK MAINTENANCE IN THE AGUA FRIA**
9 **WATER DISTRICT?**

10 **A.** The tank maintenance plan for Agua Fria is based on a 15-year schedule for
11 recommended repairs and painting. The industry-standard for tank maintenance ranges
12 from 10-15 years depending on tank material and exposure to environmental conditions
13 (water, weather, soil). We chose 15 years for several reasons: 1) the oldest tank in Agua
14 Fria, WP 2 Tank 1, will be 15 years old in 2011 and each year after the next scheduled
15 tank approaches the 15 +/- years old, 2) Agua Fria has sixteen tanks which allows the
16 Company to perform maintenance on one tank per year, with the expectation of one year
17 which includes two tanks because one tank is small at 100,000 gallons, 3) the TIC report
18 on WP2 Tank 1 concludes the tank's interior is in fair to poor condition with widespread
19 corrosion and blistering that should be repaired within the next three years, which
20 supports that 15 years is the appropriate maintenance cycle for the tanks in the Aqua Fria
21 District under the given environmental conditions, and 4) the subsequent tanks are
22 expected to be in similar condition in 15 years because the environmental conditions are
23 relatively similar among all Aqua Fria District tanks,, and 4) the schedule will lessen the
24 impact to both the customer and the Company by keeping maintenance expenses to one
25 tank a year. Please refer to Exhibit ICC-1 for detailed schedule and estimated costs.

26 The estimated yearly maintenance expense annualized over the 15-year cycle is estimated
27 to be \$376,478, as recommended as an annual revenue stream in the testimony of

1 Company witness Ms. Linda J. Gutowski. It is anticipated that this estimated expense
2 would be available for review and adjustment when necessary in subsequent Agua Fria
3 Water District rate cases.

4 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

5 **A. Yes.**

AQUA FRIA DISTRICT										TANK MAINTENANCE SCHEDULE										Exhibit 100-1
TANK																				
SITE NAME	MATERIAL	CAPACITY	APPROX. DIMENSIONS	YR BUILT	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	
A.F. WP 1 TANK 1	CONCRETE	1,325,000	75' WIDE, 20' HIGH	2000																
A.F. WP 1 TANK 2	CONCRETE	1,325,000	75' WIDE, 20' HIGH	2000																
A.F. WP 2 TANK 1	STEEL	1,000,000	108' WIDE, 16' HIGH	1996	X															
A.F. WP 2 TANK 2	STEEL	1,000,000	108' WIDE, 16' HIGH	1996		X														
A.F. WP 3 TANK 1	STEEL	1,000,000	108' WIDE, 16' HIGH	1999			X													
A.F. WP 3 TANK 2	STEEL	1,000,000	108' WIDE, 16' HIGH	1999				X												
A.F. WP 4 TANK 1	STEEL	1,500,000	135' WIDE, 16' HIGH	1998			X													
A.F. WP 4 TANK 2	STEEL	2,000,000	156' WIDE, 16' HIGH	2001																
A.F. WP 5	CONCRETE	1,450,000	127' WIDE, 16' HIGH	2004																
A.F. WP 6	STEEL	2,200,000	168' WIDE, 16' HIGH	2004																
A.F. WP 8	STEEL	100,000	135' WIDE, 16' HIGH	2004																
A.F. WP 9	STEEL	100,000	124' WIDE, 16' HIGH	2005																
A.F. WP 10 TANK 1	CONCRETE	1,735,000	124' WIDE, 20' HIGH	2007																
A.F. WP 10 TANK 2	CONCRETE	1,735,000	124' WIDE, 20' HIGH	2007																
A.F. WP 14	STEEL	2,250,000	155' WIDE, 16' HIGH	2009																
A.F. WP 100	STEEL	1,250,000	125' WIDE, 16' HIGH	2001																
COST BASIS per TCI REPORT \$ 305,500					1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	
PRICE PER GALLON \$					0.306	0.306	0.306	0.306	0.306	0.306	0.306	0.306	0.306	0.306	0.306	0.153	0.153	0.153	0.153	
ESTIMATED COST					305,500	305,500	458,250	305,500	305,500	611,000	412,625	459,250	672,100	697,375	190,838	202,384	202,384	265,021	265,021	
TOTAL ESTIMATE PROGRAM COST \$ 5,647,168																				
AVERAGE 15-YEAR ANNUALIZED COST \$ 378,478																				

ATTACHMENT 2

Staff Restatement of Ray L. Jones Rebuttal Table 1
Recent Returns on Equity Granted by the Commission

Line	Company	Docket No.	Decision No.	Date	Authorized ROE	Capital Structure	
						Debt	Equity
1	Southwest Gas Corp. ¹	G-01551A-10-0458	72723	6-Jan-12	9.50%	47.70%	52.30%
2	Bermuda Water Co.	W-01812A-10-0521	72892	17-Feb-12	8.82%	0.00%	100.00%
3	Chino Meadows II Water Co. ²	W-02370A-10-0519	72896	21-Feb-12	9.60%	0.00%	100.00%
4	Indiada Water Co.	W-02031A-10-0168, et al.	73091	5-Apr-12	10.00%	0.00%	100.00%
5	Arizona Water Co. - Western Group	W-01445A-10-0517	73144	1-May-12	10.00%	49.03%	50.97%
6	Arizona-American Water Co.	W-01303A-10-0448	73145	1-May-12	10.60%	58.73%	41.27%
7	UNS Gas Corp. ³	G-04204A-11-0158	73142	1-May-12	9.75%	49.18%	50.82%
8	Arizona Public Service Co.	E-01345A-11-0224	73183	24-May-12	10.00%	46.06%	53.94%
9	Pima Utility Co.	W-02199A-11-0329, et al.	73573	21-Nov-12	9.49%	35.36%	64.64%
10	Arizona Water Co. - Eastern Group	W-01445A-11-0310	73736	20-Feb-13	10.55%	49.03%	50.97%
11					9.83%	33.51%	66.49%
12	Average						
13							
14	New River Utility Co.					0.00%	100.00%

¹ As per the terms of a Settlement agreement, Decision No. 72723 authorized Southwest Gas an ROE of 9.5%, plus a mechanism for full revenue decoupling.

² As per Decision No 72896, Chino Meadows II was authorized an ROE of 9.6%, not 10.0% as represented by Mr. Jones (Jones Rebuttal, Table 1, p. 29).

³ As per Decision No 73142, UNS Gas was authorized an ROE of 9.75%, not 9.5% as represented by Mr. Jones (Jones Rebuttal, Table 1, p. 29).